



Ellington Financial Inc. (EFC)

Updated November 12th, 2022 by Nikolaos Sismanis

Key Metrics

Current Price:	\$14.57	5 Year CAGR Estimate:	11.8%	Market Cap:	\$880.6 M
Fair Value Price:	\$15.30	5 Year Growth Estimate:	1.5%	Ex-Dividend Date:	11/29/2022
% Fair Value:	95%	5 Year Valuation Multiple Estimate:	1.0%	Dividend Payment Date:	12/27/2022
Dividend Yield:	12.4%	5 Year Price Target	\$16.48	Years Of Dividend Growth:	1
Dividend Risk Score:	F	Retirement Suitability Score:	C	Rating:	Buy

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 \$880.6 billion and is headquartered in Old Greenwich, Connecticut.

On November 7th, 2022, Ellington Financial reported its Q3 results for the period ending September 30th, 2022. Due to the company's business model, Ellington doesn't report any revenues. Instead, it records only income. Interest income came in at \$66.8 million, 29.5% higher quarter-over-quarter. Adjusted (previously referred to as "core") earnings-per-share came in at \$0.44, three cents higher versus Q3-2021, driven by higher interest income and a lesser growth in total expenses.

The company's improving results were driven primarily by a larger residential transition loan portfolio at higher rates, partially offset by opportunistic sales, paydowns, and mark-to-market losses elsewhere in the credit portfolio.

Ellington's book value per share declined from \$16.22 to \$15.22 during the last three months, with its dividend exceeding the underlying earnings. The monthly dividend remains at \$0.15, nonetheless. Management commented that dividend coverage should resume, as earnings have already started to benefit from rising rates. Indeed, in Q3, the dividend was almost covered based on an adjusted EPS of \$0.44. We now forecast an adjusted EPS of 1.70 for FY2022.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	\$5.31	\$3.27	\$2.09	\$1.13	(\$0.48)	\$1.04	\$1.52	\$1.76	\$1.63	\$1.83	\$1.70	\$1.83
DPS	\$2.87	\$3.08	\$2.96	\$2.30	\$1.90	\$1.72	1.64	\$1.40	\$1.26	\$1.64	\$1.80	\$1.80
Shares¹	17.9	23.6	28.0	33.4	32.8	32.1	30.3	32.8	44.1	49.2	60.9	70.0

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 declined since 2015. However, the company has done its best to diversify its portfolio and reduce its performance variance. For example, 81% of its RMBS exposure is allocated to 30-year fixed mortgages.

Additionally, while around 67% of its credit portfolio is invested in residential mortgages, that 67% 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 \$2.3 million in equity gains (i.e., -0.20% of equity), while a 50bp increase in rates would result in losses of \$4.7 million (-0.40% of equity).

¹ Share count is in millions.

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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. The ongoing rise in rates should gradually grow the company's adjusted EPS, which we forecast to grow by 1% per year over the medium-term. We also anticipate the monthly dividend to remain unchanged.

Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	4.2	9.7	13.1	8.4	---	9.7	9.4	9.9	7.9	9.8	8.6	9.0
Avg. Yld.	12.9%	15.7%	12.9%	10.6%	8.0%	9.6%	9.6%	8.6%	8.2%	9.1%	12.4%	10.9%

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 10.5% over the last decade. Despite the lower DPS during the first half of 2021, the resumption of the monthly rate to \$0.15 points to a yield of 11.5%. In terms of its valuation, considering the company's latest book value of \$15.22/share, the stock is trading lower than what can be considered its fair value given its current price of \$14.57. This is likely due to investors pricing in the effect of potentially increasing rates, which could damage the equity value, as described earlier. Still, it could grow the company's earnings. We view shares as slightly undervalued currently.

Safety, Quality, Competitive Advantage, & Recession Resiliency

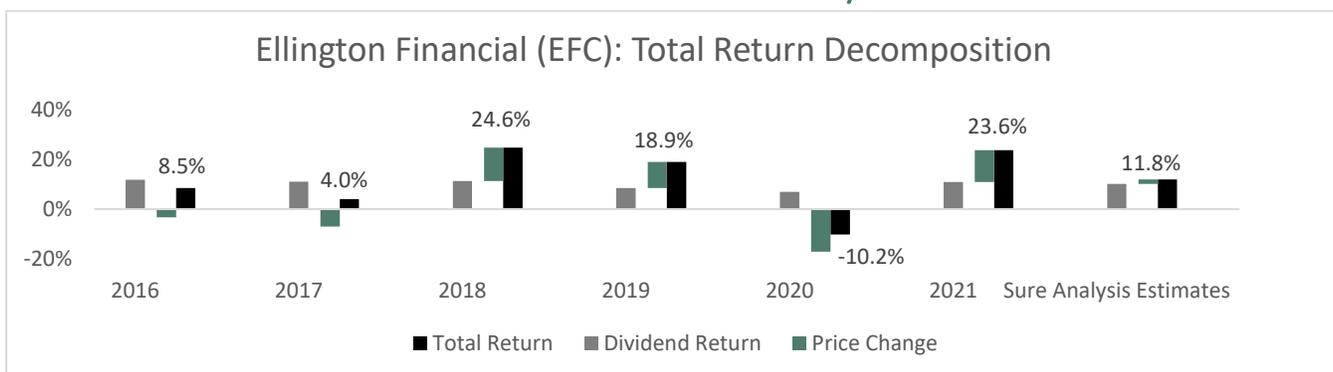
Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	54%	94%	142%	204%	---	165%	108%	80%	77%	90%	bi	98%

While management has already resumed its monthly rate since the latest dividend cut, the dividend is barely covered. Based on DPS' downward historical trajectory, slight decreases going forward are possible if profits fail to advance modestly in the coming years. The balance sheet remains has worsened lately as well, with Ellington's debt-to-equity standing at 4.1 versus 3.8 in Q2-2022. The days of mortgage REITs employing 8x or 9x leverage have come and gone, but risks attached to over-leveraged balance sheets have not evaporated.

Final Thoughts & Recommendation

Ellington Financial is a decent income-oriented stock. Since its IPO, Ellington has paid cumulative dividends in excess of \$31/share, which is 2.1X 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 11.8% in the medium-term. Investors should be aware of the fact that mortgage REITs have riskier credit profiles than traditional REITs. We rate the stock a speculative buy. The dividend should not be blindly trusted, as it could easily be cut again.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	103	87	73	53	2	53	75	82	31	122
SG&A Exp.	4	6	12	10	12	10	15	15	17	21
Net Profit	97	79	59	38	(16)	34	47	58	25	133
Net Margin	94.4%	90.5%	81.4%	72.1%	-822.1%	64.7%	62.4%	71.0%	80.6%	109%
Free Cash Flow	(51)	(244)	(604)	654	70	(463)	(494)	79	---	51

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	2,152	2,975	3,945	2,992	2,413	2,993	3,971	4,338	3,414	5,177
Cash & Equivalents	59	183	114	184	123	47	45	72	112	93
Total Liabilities	1,646	2,349	3,157	2,253	1,768	2,372	3,376	3,470	2,492	3,854
Accounts Payable	60	196	104	171	92	209	496	80	14	54
Long-Term Debt	1	1	1	---	24	268	497	830	892	3,636
Shareholder's Equity	506	620	782	732	638	600	564	718	774	1,064
LTD/E Ratio	0.00	0.00	0.00	---	0.04	0.45	0.88	1.00	1.01	2.82

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	4.7%	3.1%	1.7%	1.1%	-0.6%	1.3%	1.3%	1.4%	0.7%	3.0%
Return on Equity	22.1%	13.9%	8.4%	5.0%	-2.3%	5.5%	8.0%	9.0%	3.4%	14.5%
ROIC	22.1%	13.8%	8.4%	5.0%	-2.3%	4.4%	4.7%	4.2%	1.4%	3.2%
Shares Out.	17.9	23.6	28	33.4	32.8	32.1	30.3	32.8	43.5	48.54
Revenue/Share	5.75	3.68	2.60	1.58	0.06	1.64	2.47	2.55	0.72	2.51
FCF/Share	(2.87)	(10.36)	(21.61)	19.58	2.13	(14.44)	(16.31)	2.47	---	1.06

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

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