



Ellington Financial Inc. (EFC)

Updated March 9th, 2023 by Nikolaos Sismanis

Key Metrics

Current Price:	\$12.28	5 Year CAGR Estimate:	15.0%	Market Cap:	\$835.3 M
Fair Value Price:	\$14.53	5 Year Growth Estimate:	1.5%	Ex-Dividend Date:	03/30/2023
% Fair Value:	85%	5 Year Valuation Multiple Estimate:	3.4%	Dividend Payment Date:	04/25/2023
Dividend Yield:	14.7%	5 Year Price Target	\$15.65	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 \$835.3 billion and is headquartered in Old Greenwich, Connecticut.

On February 23rd, 2023, Ellington Financial reported its Q4-2022 and full-year results for the period ending December 31st, 2022. Due to the company's business model, Ellington doesn't report any revenues. Instead, it records only income. For the quarter, gross interest income came in at \$89.8 million, 14.2% higher quarter-over-quarter. Higher gross interest income was primarily driven primarily by a larger residential transition loan portfolio at higher rates. Adjusted (previously referred to as "core") EPS came in at \$0.42, two cents lower versus Q3-2022. For the year, EPS came in at \$1.68, down 8.2% compared to fiscal 2022. The higher cost of funds was only partially offset by higher asset yields.

Ellington's book value per share declined from \$15.22 to \$15.05 during the last three months, with its dividend exceeding the underlying earnings. The monthly dividend remains at \$0.15, nonetheless. Management commented that as they continue to rotate the portfolio into higher reinvestment yields, dividend coverage should resume. Indeed, in Q4, the dividend was almost covered based on an adjusted EPS of \$0.42. For FY2023, we forecast adjusted EPS of \$1.75.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	\$3.27	\$2.09	\$1.13	(\$0.48)	\$1.04	\$1.52	\$1.76	\$1.63	\$1.83	\$1.68	\$1.75	\$1.89
DPS	\$3.08	\$2.96	\$2.30	\$1.90	\$1.72	\$1.64	\$1.40	\$1.26	\$1.64	\$1.80	\$1.80	\$1.80
Shares¹	23.6	28	33.4	32.8	32.1	30.3	32.8	44.1	49.2	59.9	61.5	75.0

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, 80% of its RMBS exposure is allocated to 30-year fixed mortgages. Additionally, while around 68% of its credit portfolio is invested in residential mortgages, that 68% 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 \$4.3 million in equity gains (i.e., 0.43% of equity), while a 50bp increase in rates would result in losses of \$6.5million (-0.66% of equity).

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

¹ Share count is in millions.

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forecast to grow by 1.5% per year over the medium-term. We also anticipate the monthly dividend to remain unchanged. Still, if earnings fail to catch up to the dividend as management projects, a dividend is possible.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	9.7	13.1	8.4	---	9.7	9.4	9.9	7.9	9.8	8.5	7.0	8.3
Avg. Yld.	13.8%	15.1%	10.0%	8.7%	7.3%	9.2%	8.2%	7.8%	9.1%	12.6%	14.7%	11.5%

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 10.2% over the last decade. The company cut its dividend in 2020. However, the resumption of the monthly rate to \$0.15, combined with the stock declining lately, has pushed the dividend yield to nearly 15%. The market is essentially pricing the stock for another cut, though we still have hope earnings could catch up and cover it in the coming years. In terms of its valuation, considering the company's latest book value of \$15.05/share, the stock is trading lower than what can be considered its fair value given its current price of \$12.28. This is likely due to investors pricing in the negative effects of over-distributing to shareholders' equity. Still, we find the stock notably undervalued.

Safety, Quality, Competitive Advantage, & Recession Resiliency

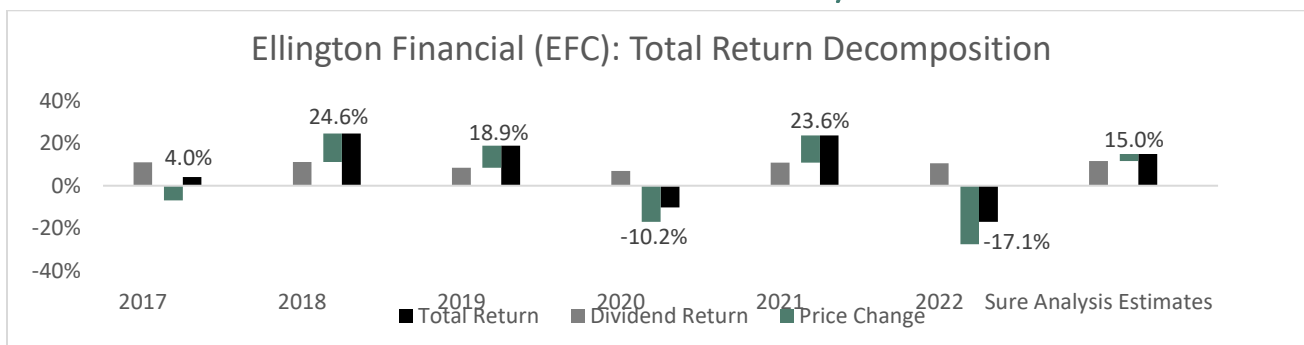
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	94%	142%	204%	-396%	165%	108%	80%	77%	90%	107%	103%	95%

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. That said, the company's balance sheet has improved lately as well, with Ellington's recourse debt-to-equity ratio adjusted for unsettled purchases and sales falling from 2.6 to 2.5 in Q4 as a result of a smaller investment portfolio as well as an increase in total equity. 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 2.5X 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 future EPS and DPS projections point to annualized returns of 15% 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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