



Orchid Island Capital, Inc. (ORC)

Updated February 28th, 2023 by Samuel Smith

Key Metrics

Current Price:	\$10.3	5 Year CAGR Estimate:	10.5%	Market Cap:	\$415M
Fair Value Price:	\$10.4	5 Year Growth Estimate:	-2.9%	Ex-Dividend Date:	5/27/23 ¹
% Fair Value:	99%	5 Year Valuation Multiple Estimate:	0.3%	Dividend Payment Date:	6/29/23 ²
Dividend Yield:	18.6%	5 Year Price Target	\$9.0	Years Of Dividend Growth:	0
Dividend Risk Score:	F	Retirement Suitability Score:	C	Rating:	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.

On February 23rd, 2023, Orchid Island Capital reported Q4 and FY2022 results. In the fourth quarter, the company reported a net income of \$34.9 million, or \$0.95 per common share, which is comprised of a net interest income of \$2.4 million, or \$0.06 per common share, and total expenses of \$5.9 million, or \$0.16 per common share. The company also reported net realized and unrealized gains of \$38.4 million, or \$1.04 per common share, on Residential Mortgage-Backed Securities (RMBS) and derivative instruments, including net interest income on interest rate swaps. The book value per common share was \$11.93 at the end of the year, and the total return was 8.67%, which is comprised of a \$0.48 dividend per common share and a \$0.51 increase in book value per common share, divided by beginning book value per common share. Other financial highlights for the company include a strong liquidity position of \$233.0 million in cash and cash equivalents and unpledged RMBS, which represents 53% of stockholder's equity as of December 31, 2022. Additionally, the company has borrowing capacity in excess of \$3,378.5 million in outstanding repurchase agreement balances as of December 31, 2022, which is spread across 20 active lenders.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
BPS	\$67.00	\$65.30	\$58.20	\$50.50	\$43.55	\$34.20	\$31.35	\$27.30	\$21.70	\$11.93	\$11.61	\$10.00
EPS	\$10.64	\$12.28	\$12.52	\$12.95	\$11.34	\$6.92	\$4.29	\$5.98	\$4.64	\$2.20	\$1.40	\$1.40
DPS	\$6.98	\$10.80	\$9.60	\$8.40	\$8.40	\$5.35	\$4.80	\$3.95	\$3.90	\$1.14	\$1.92	\$1.40
Shares³	1.7	3.3	4.4	6.6	10.6	9.7	13.0	17.0	35.4	33.4	33.4	45.0

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. Moving forward, we expect the book value per share to recover in the coming years, though the high payout will result in weakening earnings per share and dividends per share.

¹ Estimate

² Estimate

³ 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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/B	0.93	1.01	0.98	1.02	1.17	0.93	0.91	1.02	0.94	0.9	0.9	0.9
Avg. Yld.	11.2%	16.4%	16.8%	16.3%	16.5%	16.8%	16.8%	14.2%	19.1%	10.6%	18.6%	15.6%

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 0.90, compared with our fair value estimate of 0.9 which accounts for uncertainties and risks facing the business.

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

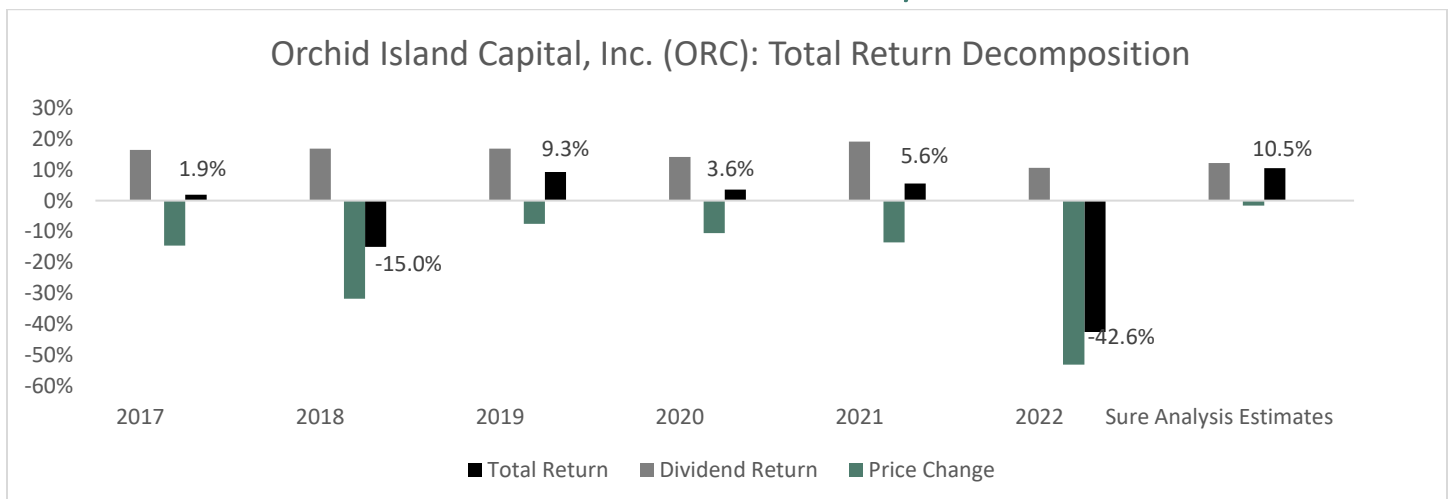
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	10%	17%	16%	17%	19%	16%	15%	14%	18%	10%	17%	14%

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. That said, it is an extremely risky stock due to its track record of consistently destroying shareholder capital and slashing its dividend repeatedly. Given that the economy is facing growing risks and headwinds, we expect book value and dividend erosion in the coming years, leading to expected annualized total return potential of 10.5%. We therefore rate the stock to be a speculative Buy.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	1	29	9	11	13	(32)	35	13	(50)	(238)
SG&A Exp.	1	4	7	8	9	9	8	8	13	3
Net Profit	(1)	25	1	2	2	(44)	24	2	(65)	(258)
Net Margin	-72.0%	84.5%	11.9%	17.9%	15.2%	137%	70.0%	16.8%	131%	108.7%
Free Cash Flow	10	12	31	47	85	94	48	55	96	289

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	364	1,658	2,242	3,139	4,023	3,396	3,882	4,058	7,069	3,866
Cash & Equivalents	8	93	57	73	214	108	194	220	385	206
Accounts Receivable	2	6	8	12	14	13	12	10	19	12
Total Liabilities	319	1,440	1,989	2,806	3,561	3,060	3,487	3,643	6,301	3,427
Accounts Payable	0	1	1	2	7	6	11	1	1	9
Long-Term Debt	-	-	188	-	-	-	-	-	-	-
Shareholder's Equity	45	218	253	333	462	336	396	415	768	439

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	-0.3%	2.4%	0.1%	0.1%	0.1%	-1.2%	0.7%	0.1%	-1.2%	-4.7%
Return on Equity	-2.3%	18.7%	0.5%	0.7%	0.5%	-11.1%	6.6%	0.5%	-10.9%	-42.8%
ROIC	-2.3%	18.7%	0.3%	0.5%	0.5%	-11.1%	6.6%	0.5%	-10.9%	-42.8%
Shares Out.	1.7	3.3	4.4	6.6	10.6	9.7	13.0	17.0	35.4	33.4
Revenue/Share	0.32	2.93	0.44	0.46	0.32	(0.62)	0.62	0.19	(0.41)	(6.35)
FCF/Share	3.35	1.18	1.52	1.95	2.07	1.80	0.86	0.82	0.80	7.72

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

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