



Ellington Residential Mortgage REIT (EARN)

Updated November 19th, 2023 by Quinn Mohammed

Key Metrics

Current Price:	\$6.01	5 Year CAGR Estimate:	14.9%	Market Cap:	\$96 M
Fair Value Price:	\$5.95	5 Year Growth Estimate:	4.0%	Ex-Dividend Date:	11/29/2023
% Fair Value:	101%	5 Year Valuation Multiple Estimate:	-0.2%	Dividend Payment Date:	12/26/2023
Dividend Yield:	16.0%	5 Year Price Target	\$7.24	Years Of Dividend Growth:	0
Dividend Risk Score:	F	Retirement Suitability Score:	C	Rating:	Buy

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 \$96 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 \$791 million and a non-agency RMBS portfolio of \$13 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 13th, 2023, Ellington Residential reported its third quarter results for the period ending September 30th, 2023. The company generated net income of (\$11.4) million, or (\$0.75) per share. Ellington achieved adjusted distributable earnings of \$3.2 million in the quarter, leading to adjusted earnings of \$0.21 per share, which did not cover the dividend paid in the period. Ellington's net interest margin improved sequentially to 1.24% in Q3. At quarter end, Ellington had \$40.0 million of cash and cash equivalents, and \$2.7 million of other unencumbered assets. The debt-to-equity ratio was 7.3X. Book value per share declined from the previous quarter, to \$7.02, a 14% sequential decrease.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Adj. EPS	\$2.09	\$3.04	\$2.41	\$1.71	\$1.91	\$1.34	\$0.91	\$1.26	\$1.27	\$1.06	\$0.85	\$1.03
DPS	\$1.14	\$2.20	\$2.00	\$1.65	\$1.57	\$1.45	\$1.18	\$1.12	\$1.18	\$1.04	\$0.96	\$0.96
Shares¹	6.6	9.1	9.1	9.1	11.6	12.8	12.5	12.4	12.7	12.7	15.5	18.0

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 2017, the compound annual growth rate has been -11.1%. In its first few years, the company held its 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 revolve around optimizing its MBS portfolio. Capitalizing on opportunities driven by market volatility and uncertainty could yield results, as well as continuing to rotate capital to non-Agency RMBS. Additionally, Ellington will protect its book value and manage volatility through interest rate hedges and liquidity management. Despite this, the company has a poor track record of earnings growth, leading us to anticipate mid-single digit growth of 4.0%. The dividend has been cut every single year (results from 2013 only account for half the year) in its history with 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%.

¹ Share count is 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	2023	2028
Avg. P/E	7.8	5.6	6.1	7.4	7.4	8.3	12.2	8.3	9.3	7.8	7.1	7.0
Avg. Yld.	7.0%	10.3%	14.4%	13.8%	10.9%	13.1%	11.7%	10.8%	9.4%	14.3%	16.0%	13.3%

Ellington's P/E ratio has hovered around 8.0 times core earnings since 2013, and 9.2 times since 2018. Today, EARN trades at 7.1 times earnings, below its historical valuation. We peg fair value at 7.0 times earnings; thus, we estimate a small valuation headwind to total annual returns. The current 16% yield is in excess of its historic average of 11.6%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

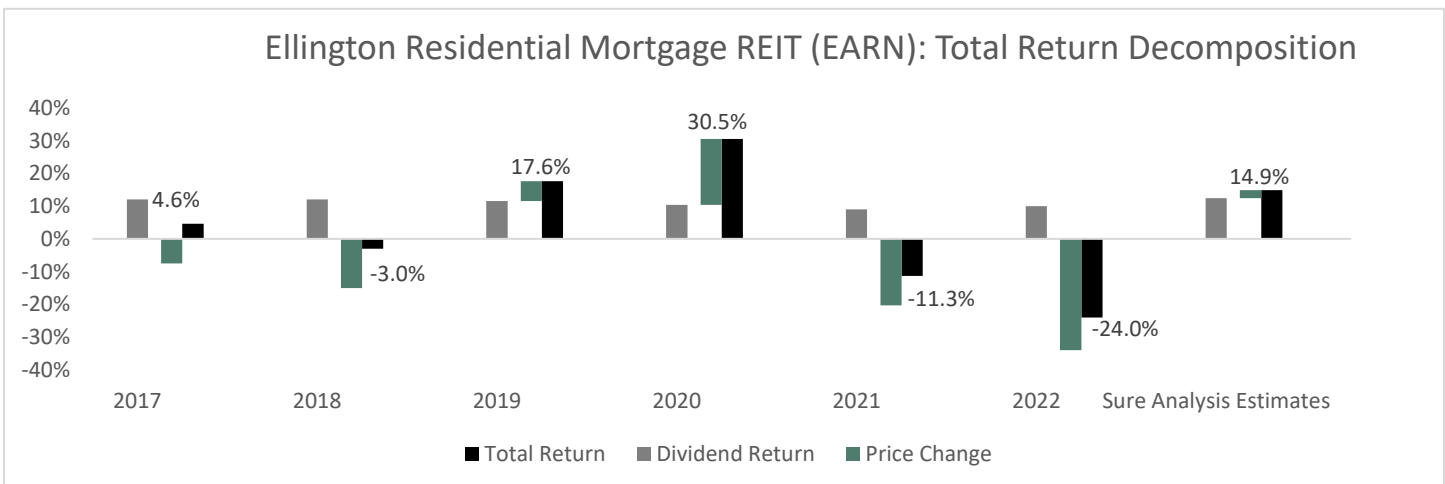
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	55%	72%	83%	96%	82%	108%	130%	89%	93%	98%	113%	93%

EARN's dividend is far from trustworthy given the corporation has a trail of cuts in the rearview. In at least four years of the last eight full calendar years in operation, the company's payout ratio was near or above 100%. Currently, even after another dividend cut, the dividend appears to be under heavy pressure. Ellington claims that its portfolio managers are among the most experienced in the MBS sector and their analytics have been developed over the company's 28-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 14.9% in the intermediate term, driven almost entirely by the stock's 16% yield. We also assume a 4% annual adjusted distributable earnings growth rate and a potential for a valuation headwind. Ellington Residential receives a speculative buy rating due to strong forecasted returns, but we warn it has an abysmal dividend history and 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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	2	22	5	17	16	(6)	28	26	(1)	-25
SG&A Exp.	2	3	3	3	4	3	3	3	4	1
Net Profit	(2)	16	0	12	11	(11)	22	20	(6)	-30
Net Margin	-79.4%	73.8%	0.6%	70.4%	65.4%	195%	80.8%	77.5%	1132%	120.5%
Free Cash Flow	26	21	25	20	34	29	18	24	28	22

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	1,511	1,521	1,557	1,429	1,887	1,676	1,489	1,195	1,598	1054
Cash & Equivalents	50	45	40	34	56	19	35	58	69	35
Accounts Receivable	5	5	4	5	6	6	5	4	5	3
Total Liabilities	1,344	1,358	1,412	1,287	1,694	1,522	1,328	1,028	1,444	941
Accounts Payable	24	1	2	3	4	6	4	2	3	50
Shareholder's Equity	167	163	145	142	193	154	161	166	154	112

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	---	1.1%	0.0%	0.8%	0.7%	-0.6%	1.4%	1.5%	-0.5%	-2.3%
Return on Equity	-1.9%	9.8%	0.0%	8.3%	6.5%	-6.5%	14.1%	12.3%	-3.9%	-22.7%
ROIC	---	9.8%	0.0%	8.3%	6.5%	-6.5%	14.1%	12.3%	-3.9%	-22.7%
Shares Out.	6.6	9.1	9.1	9.1	11.6	12.8	12.5	12.4	12.7	13.16
Revenue/Share	0.37	2.40	0.57	1.85	1.42	(0.45)	2.21	2.10	-0.04	-1.90
FCF/Share	3.88	2.33	2.71	2.18	2.97	2.25	1.41	1.97	2.20	1.70

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

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