



Ellington Financial Inc. (EFC)

Updated November 13th, 2023 by Nikolaos Sismanis

Key Metrics

Current Price:	\$12.70	5 Year CAGR Estimate:	13.7%	Market Cap:	\$866.6 M
Fair Value Price:	\$14.40	5 Year Growth Estimate:	1.0%	Ex-Dividend Date:	11/29/2023
% Fair Value:	88%	5 Year Valuation Multiple Estimate:	2.5%	Dividend Payment Date:	12/26/2023
Dividend Yield:	14.2%	5 Year Price Target	\$15.13	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 \$866.6 million and is headquartered in Old Greenwich, Connecticut.

On November 7th, 2023, Ellington Financial reported its Q3 results for the period ending September 30th, 2023. 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 \$96.2 million, up 9.2% quarter-over-quarter. Adjusted (previously referred to as "core") EPS came in at \$0.33, five cents lower versus Q2-2023. The decline was mainly due to higher professional fees.

Ellington's book value per share fell from \$14.70 to \$14.33 during the last three months, with its dividends exceeding the underlying income. The monthly dividend remains at \$0.15, nonetheless. Management commented that dividend coverage should resume as they continue to rotate the portfolio into higher reinvestment yields. We have utilized an adjusted EPS power of \$1.80 in our estimates. However, the actual figure for the year should land close to \$1.55.

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	\$1.55	\$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	68.6	80.0

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, 85% of its RMBS exposure is allocated to 30-year fixed mortgages. Additionally, while around 70% of its credit portfolio is invested in residential mortgages, that 70% 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 \$13.1 million in equity losses (i.e., -1.29% of equity), while a 50bp increase in rates would result in gains of \$8.3 million (+0.82% 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. Still, the ongoing rise in rates should gradually grow the company's adjusted EPS, which we forecast to grow by 1.0% 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 cut is possible.

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	Now	2028
Avg. P/E	9.7	13.1	8.4	---	9.7	9.4	9.9	7.9	9.8	8.5	7.1	8.0
Avg. Yld.	13.8%	15.1%	10.0%	8.7%	7.3%	9.2%	8.2%	7.8%	9.1%	12.6%	14.2%	11.9%

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 10.2% 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 above 14%. 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. Regarding the stock's valuation, we believe that Ellington is undervalued at 7.1 times its adjusted EPS. This is likely due to investors pricing in the negative effects of over-distributing to shareholders' equity. Still, a multiple expansion from here is possible, especially if the company's earnings catch up to the dividend.

Safety, Quality, Competitive Advantage, & Recession Resiliency

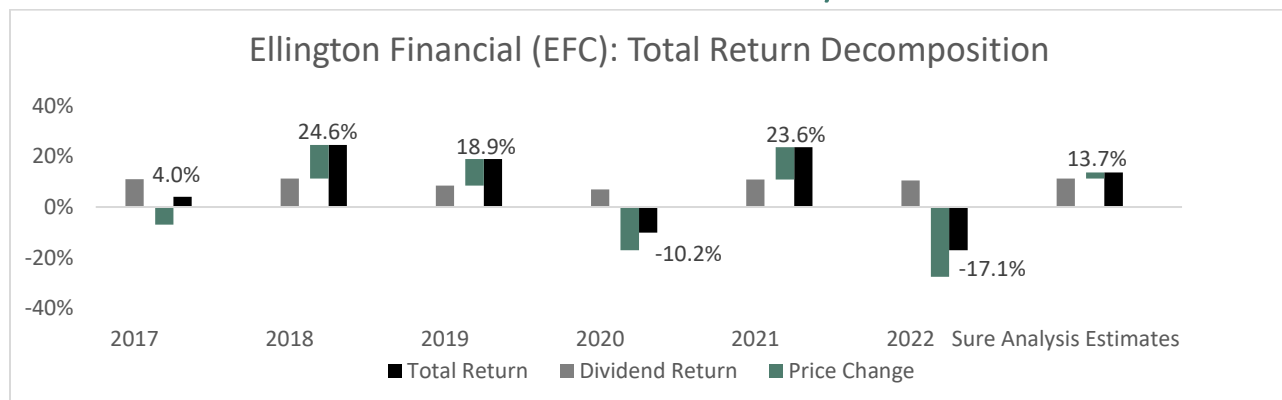
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	94%	142%	204%	-396%	165%	108%	80%	77%	90%	107%	100%	95%

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, despite Ellington's recourse debt-to-equity ratio adjusted for unsettled purchases and sales rising from 2.0 to 2.1 in Q2 as the result of a smaller investment portfolio, an increase in unencumbered assets, and 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 \$32/share, which equals nearly 2.3x 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 13.7% 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, but note that 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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	87	73	53	2	53	75	82	31	122	43
SG&A Exp.	6	12	10	12	10	15	15	17	21	30
Net Profit	79	59	38	(16)	34	47	58	25	133	(70)
Net Margin	90.5%	81.4%	72.1%	-822.1%	64.7%	62.4%	71.0%	80.6%	109%	(163%)
Free Cash Flow	(244)	(604)	654	70	(463)	(494)	79	---	51	43

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	2,975	3,945	2,992	2,413	2,993	3,971	4,338	3,414	5,177	14,090
Cash & Equivalents	183	114	184	123	47	45	72	112	93	317
Total Liabilities	2,349	3,157	2,253	1,768	2,372	3,376	3,470	2,492	3,854	12,860
Accounts Payable	196	104	171	92	209	496	80	14	54	84
Long-Term Debt	1	1	---	24	268	497	830	892	3,636	12,400
Shareholder's Equity	620	782	732	638	600	564	718	774	1,064	967
LTD/E Ratio	0.00	0.00	---	0.04	0.45	0.88	1.00	1.01	2.82	10.37

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	3.1%	1.7%	1.1%	-0.6%	1.3%	1.3%	1.4%	0.7%	3.0%	(0.73%)
Return on Equity	13.9%	8.4%	5.0%	-2.3%	5.5%	8.0%	9.0%	3.4%	14.5%	(6.9%)
ROIC	13.8%	8.4%	5.0%	-2.3%	4.4%	4.7%	4.2%	1.4%	3.2%	(0.8%)
Shares Out.	23.6	28	33.4	32.8	32.1	30.3	32.8	43.5	48.54	59.85
Revenue/Share	3.68	2.60	1.58	0.06	1.64	2.47	2.55	0.72	2.51	0.72
FCF/Share	(10.36)	(21.61)	19.58	2.13	(14.44)	(16.31)	2.47	---	1.06	0.71

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

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