



Orchid Island Capital, Inc. (ORC)

Updated February 15th, 2024 by Samuel Smith

Key Metrics

Current Price:	\$8.36	5 Year CAGR Estimate:	0.8%	Market Cap:	\$432M
Fair Value Price:	\$8.19	5 Year Growth Estimate:	-11.3%	Ex-Dividend Date:	2/28/24
% Fair Value:	102%	5 Year Valuation Multiple Estimate:	-0.4%	Dividend Payment Date:	3/26/24
Dividend Yield:	17.2%	5 Year Price Target	\$4.50	Years Of Dividend Growth:	0
Dividend Risk Score:	F	Retirement Suitability Score:	C	Rating:	Sell

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 2, 2024, Orchid Island Capital (NYSE: ORC) disclosed its financial outcomes for the fourth quarter of 2023 amidst a turbulent market environment. The company reported a net income of \$0.52 per share and observed a 2% increase in its book value, reaching \$9.10. Additionally, a dividend of \$0.36 per share was declared and paid, reflecting a total return of 6.05% for the quarter. Orchid Island Capital undertook strategic adjustments to its investment portfolio during this period. These adjustments included a reduction in exposure to 3% coupon securities and an increase in higher coupon securities, contributing to an improved economic net interest spread and overall financial performance. The company also added SOFR futures to hedge against potential Federal Reserve easing, indicating a proactive approach to navigating the volatile interest rate landscape.

Despite the challenges presented by volatility in interest rates and an inverted yield curve, which introduced uncertainty regarding Federal Reserve actions, the company's strategic portfolio realignment and hedging measures have led to an improved economic net interest spread. This suggests a resilient performance in the face of market unpredictability. The re-emergence of banks in the mortgage market was also discussed as a potential influencer of future interest rates and spreads. However, executives expressed caution about expanding the dividend amidst the uncertain market conditions, highlighting concerns over a possible wage-price spiral and its impact on interest rates.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
BPS	\$65.30	\$58.20	\$50.50	\$43.55	\$34.20	\$31.35	\$27.30	\$21.70	\$11.93	\$9.10	\$9.10	\$5.00
EPS	\$12.28	\$12.52	\$12.95	\$11.34	\$6.92	\$4.29	\$5.98	\$4.64	\$2.20	(\$0.96)	(\$0.25)	\$0.60
DPS	\$10.80	\$9.60	\$8.40	\$8.40	\$5.35	\$4.80	\$3.95	\$3.90	\$1.14	\$1.44	\$1.44	\$0.55
Shares¹	3.3	4.4	6.6	10.6	9.7	13.0	17.0	35.4	39.1	51.6	51.6	65.0

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.

¹ In millions

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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 continue declining in the coming years and the high payout will result in weakening earnings per share and dividends per share.

Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/B	1.01	0.98	1.02	1.17	0.93	0.91	1.02	0.94	0.9	1.0	0.9	0.9
Avg. Yld.	16.4%	16.8%	16.3%	16.5%	16.8%	16.8%	14.2%	19.1%	10.6%	15.8%	17.2%	12.2%

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 0.9, in-line 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 multiple times 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.

Safety, Quality, Competitive Advantage, & Recession Resiliency

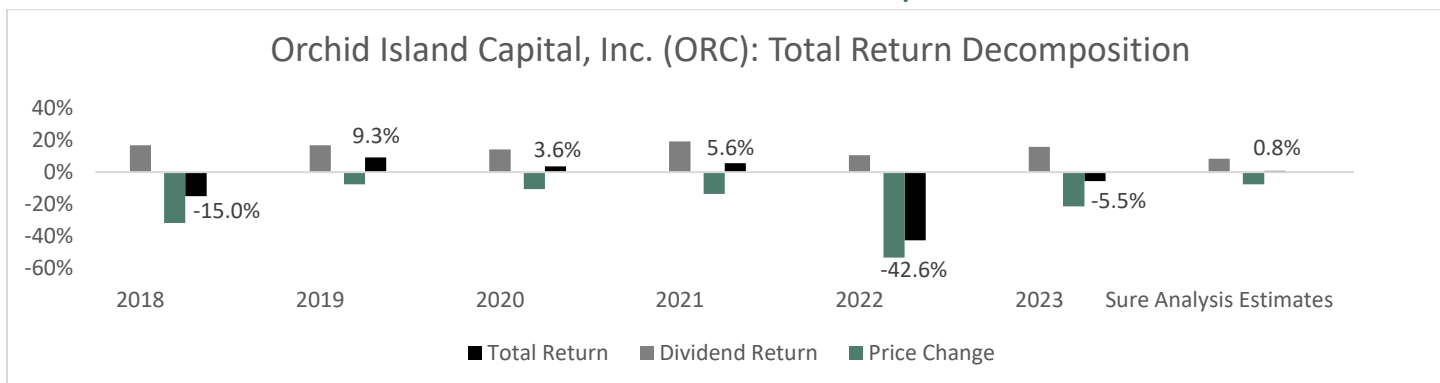
Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	88%	77%	65%	74%	77%	112%	66%	84%	52%	NA	NA	92%

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 just 0.8%. We therefore rate the stock as a Sell.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	29	9	11	13	(32)	35	13	(50)	(238)	(21)
SG&A Exp.	1	2	2	2	2	1	2	3	3	
Net Profit	25	1	2	2	(44)	24	2	(65)	(258)	(39)
Net Margin	84.5%	11.9%	17.9%	15.2%	136.9%	70.0%	16.8%	130.8%	108.7%	189.5%
Free Cash Flow	12	31	47	85	94	48	55	96	289	

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	1,658	2,242	3,139	4,023	3,396	3,882	4,058	7,069	3,866	4,265
Cash & Equivalents	93	57	73	214	108	194	220	385	206	200
Accounts Receivable	6	8	12	14	13	12	10	19	12	15
Total Liabilities	1,440	1,989	2,806	3,561	3,060	3,487	3,643	6,301	3,427	3,795
Accounts Payable	1	1	2	7	6	11	1	1	9	8
Long-Term Debt	-	188	-	-	-	-	-	-	-	-
Shareholder's Equity	218	253	333	462	336	396	415	768	439	470

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	2.4%	0.1%	0.1%	0.1%	-1.2%	0.7%	0.1%	-1.2%	-4.7%	-1.0%
Return on Equity	18.7%	0.5%	0.7%	0.5%	-11.1%	6.6%	0.5%	-10.9%	-42.8%	-8.6%
ROIC	18.7%	0.3%	0.5%	0.5%	-11.1%	6.6%	0.5%	-10.9%	-42.8%	-8.6%
Shares Out.	3.3	4.4	6.6	10.6	9.7	13.0	17.0	35.4	39.1	51.6
Revenue/Share	14.66	2.21	2.30	1.60	(3.11)	3.08	0.94	(2.04)	(6.35)	(0.46)
FCF/Share	5.89	7.58	9.76	10.35	9.00	4.28	4.12	3.98	7.72	

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

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