



# Ellington Financial Inc. (EFC)

Updated August 21<sup>st</sup>, 2024 by Nikolaos Sismanis

## Key Metrics

<b>Current Price:</b>	\$13.14	<b>5 Year CAGR Estimate:</b>	8.4%	<b>Market Cap:</b>	\$1.14 B
<b>Fair Value Price:</b>	\$11.90	<b>5 Year Growth Estimate:</b>	1.0%	<b>Ex-Dividend Date:</b>	08/30/2024
<b>% Fair Value:</b>	110%	<b>5 Year Valuation Multiple Estimate:</b>	-2.0%	<b>Dividend Payment Date:</b>	09/25/2024
<b>Dividend Yield:</b>	11.9%	<b>5 Year Price Target</b>	\$12.51	<b>Years Of Dividend Growth:</b>	N/A
<b>Dividend Risk Score:</b>	F	<b>Retirement Suitability Score:</b>	C	<b>Rating:</b>	Hold

## 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 \$1.14 billion and is headquartered in Old Greenwich, Connecticut.

On August 6<sup>th</sup>, 2024, Ellington Financial reported its Q2 results for the period ending June 30<sup>th</sup>, 2024. Due to the nature company's business model, Ellington doesn't report any revenues. Instead, it records only income. For the quarter, gross interest income came in at \$104.3 million, up 2.8% quarter-over-quarter.

Adjusted (previously referred to as "core") EPS came in at \$0.33, five cents higher versus Q1-2024. The rise was mainly due to higher interest income against stable interest expenses, offset by a higher share count.

Ellington's book value per share rose from \$13.69 to \$13.92 during the last three months. Back in Q4-2023, management cut the dividend from a monthly rate of \$0.15 to \$0.13, which the board approved, to build some equity value up. Still, the company has yet to show strong enough results to confidently cover even this reduced dividend rate. Management mentioned that they feel confident about the current dividend level, but its future remains to be seen. We see adjusted EPS of \$1.40 in FY2024.

## Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
<b>EPS</b>	\$2.09	\$1.13	(\$0.48)	\$1.04	\$1.52	\$1.76	\$1.63	\$1.83	\$1.68	\$2.52	<b>\$1.40</b>	<b>\$1.47</b>
<b>DPS</b>	\$2.96	\$2.30	\$1.90	\$1.72	\$1.64	\$1.40	\$1.26	\$1.64	\$1.80	\$1.80	<b>\$1.56</b>	<b>\$1.34</b>
<b>Shares<sup>1</sup></b>	28.0	33.4	32.8	32.1	30.3	32.8	44.1	49.2	59.9	68.3	<b>85.8</b>	<b>100.0</b>

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, 853% 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 \$6.6 million in equity gains (i.e., 0.42 % of equity), while a 50bp increase in rates would also result in losses of \$11.6million (-0.74% 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 current setup appears to more or less drive some downside. We adjusted EPS to

<sup>1</sup> Share count is in millions.

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grow by 1.0% per year over the medium-term, hoping that Ellington's trajectory improves from here. We have also set the medium-term dividend growth rate at a negative 3% to factor in the possibility of another cut during this period.

## Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	13.1	8.4	---	9.7	9.4	9.9	7.9	9.8	8.5	4.6	9.4	8.5
Avg. Yld.	15.1%	10.0%	8.7%	7.3%	9.2%	8.2%	7.8%	9.1%	12.6%	15.5%	11.9%	10.7%

Ellington cut its dividend in 2020. While management did resume the monthly rate to its previous monthly rate of \$0.15 in the coming years, the dividend was cut again entering 2024. The current discount in Ellington's valuation likely reflects ongoing concerns regarding the possibility of another dividend cut. We see the potential for further compression in the stock's valuation, even in light of its seemingly appealing dividend yield.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

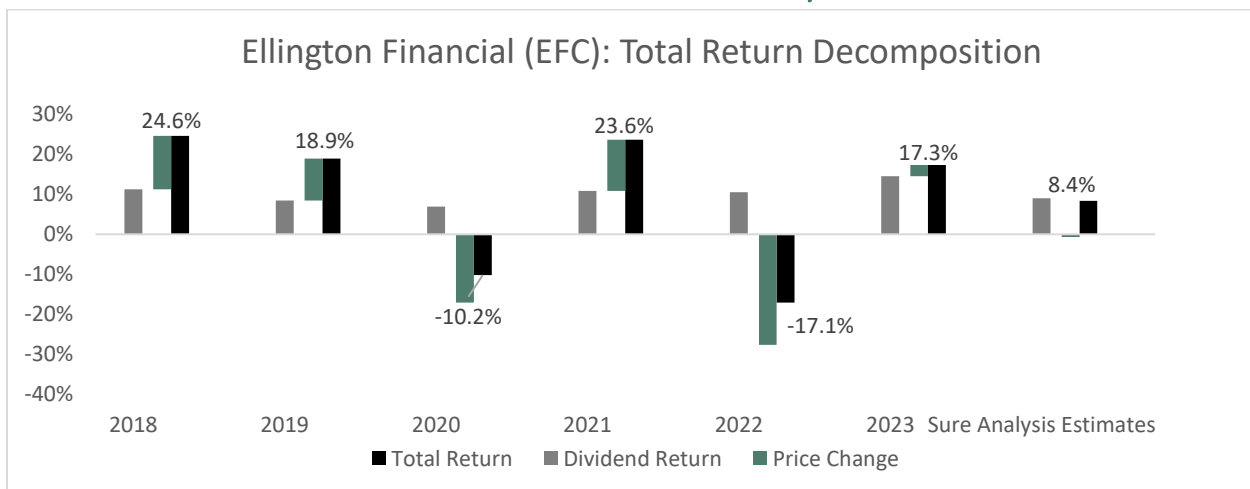
Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	142%	204%	-396%	165%	108%	80%	77%	90%	107%	71%	111%	91%

We don't consider Ellington's dividend safe at this point, with a rollercoaster of cuts and hikes in recent years hampering the stock's investment case. Still, the most recent cut should allow Ellington to build some equity value on the balance sheet and potentially improve the overall margin of safety for investors. 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. In this case, it's worth mentioning the recourse debt to equity ratio decreased to 1.8:1 in Q2, down from 2:1 at the end of last year, due to a decline in borrowings on its smaller, but more highly levered Agency RMBS portfolio and a fall in its recourse borrowings related to its securitization of proprietary reverse mortgage loans in March.

## Final Thoughts & Recommendation

Since its IPO, Ellington has paid cumulative dividends of nearly \$34/share, which equals over 1.5x its IPO share price of about \$22.50 in 2010. 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 (current price of \$13.14). Our future EPS and DPS projections point to annualized returns of 8.4% 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 as a hold, but, as highlighted in prior reports, we note that the dividend should not be blindly trusted.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
<b>Revenue</b>	73	53	2	53	75	82	31	122	43	257
<b>SG&amp;A Exp.</b>	12	10	12	10	15	15	17	21	30	68
<b>Net Profit</b>	59	38	(16)	34	47	58	25	133	(70)	84
<b>Net Margin</b>	81.4%	72.1%	-822.1%	64.7%	62.4%	71.0%	80.6%	109%	(163%)	32.7%
<b>Free Cash Flow</b>	(604)	654	70	(463)	(494)	79	---	51	43	(242)

## Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
<b>Total Assets</b>	3,945	2,992	2,413	2,993	3,971	4,338	3,414	5,177	14,090	15,320
<b>Cash &amp; Equivalents</b>	114	184	123	47	45	72	112	93	317	229
<b>Total Liabilities</b>	3,157	2,253	1,768	2,372	3,376	3,470	2,492	3,854	12,860	13,780
<b>Accounts Payable</b>	104	171	92	209	496	80	14	54	84	72
<b>Long-Term Debt</b>	1	---	24	268	497	830	892	3,636	12,400	13,330
<b>Shareholder's Equity</b>	782	732	638	600	564	718	774	1,064	967	1,162
<b>LTD/E Ratio</b>	0.00	---	0.04	0.45	0.88	1.00	1.01	2.82	10.37	8.80

## Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
<b>Return on Assets</b>	1.7%	1.1%	-0.6%	1.3%	1.3%	1.4%	0.7%	3.0%	(0.73%)	0.6%
<b>Return on Equity</b>	8.4%	5.0%	-2.3%	5.5%	8.0%	9.0%	3.4%	14.5%	(6.9%)	6.1%
<b>ROIC</b>	8.4%	5.0%	-2.3%	4.4%	4.7%	4.2%	1.4%	3.2%	(0.8%)	0.6%
<b>Shares Out.</b>	28	33.4	32.8	32.1	30.3	32.8	43.5	48.54	59.85	68.25
<b>Revenue/Share</b>	2.60	1.58	0.06	1.64	2.47	2.55	0.72	2.51	0.72	3.76
<b>FCF/Share</b>	(21.61)	19.58	2.13	(14.44)	(16.31)	2.47	---	1.06	0.71	(3.54)

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

### Disclaimer

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