



Ellington Financial Inc. (EFC)

Updated November 27th, 2024 by Nikolaos Sismanis

Key Metrics

| | | | | | |
|-----------------------------|---------|--|---------|----------------------------------|------------|
| Current Price: | \$12.37 | 5 Year CAGR Estimate: | 9.7% | Market Cap: | \$1.12 B |
| Fair Value Price: | \$11.90 | 5 Year Growth Estimate: | 1.0% | Ex-Dividend Date: | 11/29/2024 |
| % Fair Value: | 104% | 5 Year Valuation Multiple Estimate: | -0.8% | Dividend Payment Date: | 12/26/2024 |
| Dividend Yield: | 12.6% | 5 Year Price Target | \$12.51 | Years Of Dividend Growth: | N/A |
| Dividend Risk Score: | F | Retirement Suitability Score: | C | Rating: | 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 \$1.12 billion and is headquartered in Old Greenwich, Connecticut.

On November 6th, 2024, Ellington Financial reported its Q3 results for the period ending September 30th, 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 \$101.7 million, up 2.5% quarter-over-quarter.

Adjusted (previously referred to as "core") EPS came in at \$0.40, seven cents higher versus Q2-2024. The rise was driven in part by a sizeable contribution from Ellington's proprietary reverse mortgage strategy, offset by a higher share count.

Ellington's book value per share fell from \$13.92 to \$13.66 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 |
|---------------------------|--------|--------|----------|--------|--------|--------|--------|--------|--------|--------|---------------|---------------|
| EPS | \$2.09 | \$1.13 | (\$0.48) | \$1.04 | \$1.52 | \$1.76 | \$1.63 | \$1.83 | \$1.68 | \$2.52 | \$1.40 | \$1.47 |
| DPS | \$2.96 | \$2.30 | \$1.90 | \$1.72 | \$1.64 | \$1.40 | \$1.26 | \$1.64 | \$1.80 | \$1.80 | \$1.56 | \$1.34 |
| Shares¹ | 28.0 | 33.4 | 32.8 | 32.1 | 30.3 | 32.8 | 44.1 | 49.2 | 59.9 | 68.3 | 88.0 | 100.0 |

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 73% of its credit portfolio is invested in residential mortgages, that 73% 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 just \$5.8 million in equity losses (i.e., -0.46 % of equity), while a 50bp increase in rates would also result in losses of \$1.6 million (-0.12% 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

¹ 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 | 8.8 | 8.5 |
| Avg. Yld. | 15.1% | 10.0% | 8.7% | 7.3% | 9.2% | 8.2% | 7.8% | 9.1% | 12.6% | 15.5% | 12.6% | 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

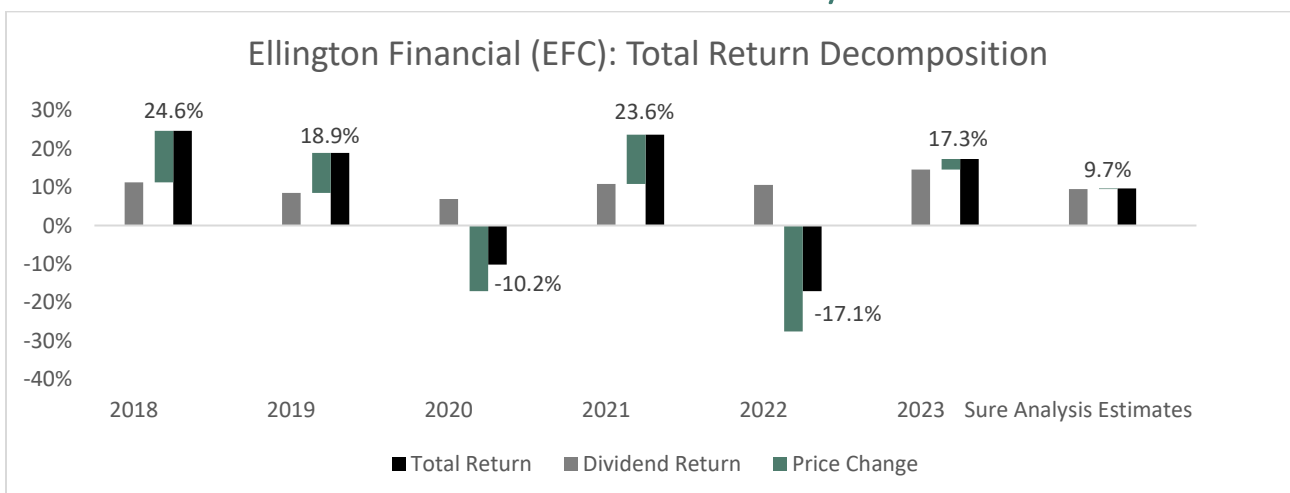
| Year | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2029 |
|--------|------|------|-------|------|------|------|------|------|------|------|------|------|
| Payout | 142% | 204% | -396% | 165% | 108% | 80% | 77% | 90% | 107% | 71% | 111% | 91% |

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 Q3, 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 about \$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 \$12.37). Our future EPS and DPS projections point to annualized returns of 9.7% 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 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 |
|-----------------------|-------|-------|---------|-------|-------|-------|-------|------|--------|-------|
| Revenue | 73 | 53 | 2 | 53 | 75 | 82 | 31 | 122 | 43 | 257 |
| SG&A Exp. | 12 | 10 | 12 | 10 | 15 | 15 | 17 | 21 | 30 | 68 |
| Net Profit | 59 | 38 | (16) | 34 | 47 | 58 | 25 | 133 | (70) | 84 |
| Net Margin | 81.4% | 72.1% | -822.1% | 64.7% | 62.4% | 71.0% | 80.6% | 109% | (163%) | 32.7% |
| Free Cash Flow | (604) | 654 | 70 | (463) | (494) | 79 | --- | 51 | 43 | (242) |

Balance Sheet Metrics

| Year | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|-------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|--------|--------|
| Total Assets | 3,945 | 2,992 | 2,413 | 2,993 | 3,971 | 4,338 | 3,414 | 5,177 | 14,090 | 15,320 |
| Cash & Equivalents | 114 | 184 | 123 | 47 | 45 | 72 | 112 | 93 | 317 | 229 |
| Total Liabilities | 3,157 | 2,253 | 1,768 | 2,372 | 3,376 | 3,470 | 2,492 | 3,854 | 12,860 | 13,780 |
| Accounts Payable | 104 | 171 | 92 | 209 | 496 | 80 | 14 | 54 | 84 | 72 |
| Long-Term Debt | 1 | --- | 24 | 268 | 497 | 830 | 892 | 3,636 | 12,400 | 13,330 |
| Shareholder's Equity | 782 | 732 | 638 | 600 | 564 | 718 | 774 | 1,064 | 967 | 1,162 |
| LTD/E Ratio | 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 |
|-------------------------|---------|-------|-------|---------|---------|------|------|-------|---------|--------|
| Return on Assets | 1.7% | 1.1% | -0.6% | 1.3% | 1.3% | 1.4% | 0.7% | 3.0% | (0.73%) | 0.6% |
| Return on Equity | 8.4% | 5.0% | -2.3% | 5.5% | 8.0% | 9.0% | 3.4% | 14.5% | (6.9%) | 6.1% |
| ROIC | 8.4% | 5.0% | -2.3% | 4.4% | 4.7% | 4.2% | 1.4% | 3.2% | (0.8%) | 0.6% |
| Shares Out. | 28 | 33.4 | 32.8 | 32.1 | 30.3 | 32.8 | 43.5 | 48.54 | 59.85 | 68.25 |
| Revenue/Share | 2.60 | 1.58 | 0.06 | 1.64 | 2.47 | 2.55 | 0.72 | 2.51 | 0.72 | 3.76 |
| FCF/Share | (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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