



Ellington Credit Company (EARN)

Updated December 2nd, 2024 by Quinn Mohammed

Key Metrics

| | | | | | |
|-----------------------------|--------|--|--------|----------------------------------|------------|
| Current Price: | \$6.73 | 5 Year CAGR Estimate: | 15.6% | Market Cap: | \$194 M |
| Fair Value Price: | \$8.26 | 5 Year Growth Estimate: | 2.0% | Ex-Dividend Date: | 11/29/2024 |
| % Fair Value: | 81% | 5 Year Valuation Multiple Estimate: | 4.2% | Dividend Payment Date: | 12/26/2024 |
| Dividend Yield: | 14.3% | 5 Year Price Target | \$9.12 | Years Of Dividend Growth: | 0 |
| Dividend Risk Score: | F | Retirement Suitability Score: | B | Rating: | Buy |

Overview & Current Events

Ellington Credit Company 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 \$194 million. Ellington Credit Company is externally managed by an affiliate of Ellington Management Group, LLC.

The company has an agency residential mortgage-backed securities (RMBS) portfolio of \$462 million and a non-agency RMBS portfolio of \$9.4 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.

In April 2024, Ellington Residential Mortgage REIT changed its name to Ellington Credit Company, and announced its intention to transform into a collateralized loan obligations (“CLOs”)-focused company. It expects this transformation to be completed this year, and will move away from its focus on MBS. It has terminated its REIT status and expects to become a closed end fund by the end of this year, and treated as a regulated investment company. It has announced that it is maintaining its \$0.08 monthly dividend during this transition.

On November 12th, 2024, Ellington Residential reported its third quarter results for the period ending September 30th, 2024. The company generated net income of \$5.4 million, or \$0.21 per share. Ellington achieved adjusted distributable earnings of \$7.2 million in the quarter, leading to adjusted earnings of \$0.28 per share, which covered the dividend paid in the period. Ellington’s net interest margin was 5.22% overall. At quarter end, Ellington had \$25.7 million of cash and cash equivalents, and \$96 million of other unencumbered assets. The debt-to-equity ratio was 2.5X. Book value per share saw a reduction from the previous quarter to \$6.85, a 1% sequential decrease.

Growth on a Per-Share Basis

| Year | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2029 |
|---------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------------|---------------|
| Adj. EPS | \$3.04 | \$2.41 | \$1.71 | \$1.91 | \$1.34 | \$0.91 | \$1.26 | \$1.27 | \$1.06 | \$0.86 | \$1.18 | \$1.30 |
| DPS | \$2.20 | \$2.00 | \$1.65 | \$1.57 | \$1.45 | \$1.18 | \$1.12 | \$1.18 | \$1.04 | \$0.96 | \$0.96 | \$0.96 |
| Shares¹ | 9.1 | 9.1 | 9.1 | 11.6 | 12.8 | 12.5 | 12.4 | 12.7 | 12.7 | 14.9 | 25.6 | 35.0 |

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 2018, the compound annual growth rate has been -8.5%. 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. In April 2024, Ellington Credit began the refocusing and rotation of its portfolio into CLOs. In the most recent quarter, the company nearly doubled its CLO portfolio again to \$145 million. Given the refocusing of Ellington’s business plan, along with its poor track record of earnings growth, we expect low single digit growth of 2%. The dividend has been cut every single year in its history with an increase in 2021,

¹ Share count is in millions.

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followed by the dividend schedule being modified to monthly over quarterly, which some shareholders may appreciate. And in May 2022, the dividend was cut again, by 20%.

Valuation Analysis

| Year | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | Now | 2029 |
|-----------|-------|-------|-------|-------|-------|-------|-------|------|-------|-------|-------|-------|
| Avg. P/E | 5.6 | 6.1 | 7.4 | 7.4 | 8.3 | 12.2 | 8.3 | 9.3 | 7.8 | 8.0 | 5.7 | 7.0 |
| Avg. Yld. | 10.3% | 14.4% | 13.8% | 10.9% | 13.1% | 11.7% | 10.8% | 9.4% | 15.0% | 14.4% | 14.3% | 10.5% |

Ellington's P/E ratio has hovered around 8.0 times core earnings since 2014, and 9.1 times since 2018. Today, EARN trades at 5.7 times earnings, below its historical valuation. We peg fair value at 7.0 times earnings; thus, we forecast a moderate valuation tailwind to total annual returns. The current 14.3% yield is in excess of its historic average of 12.4%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

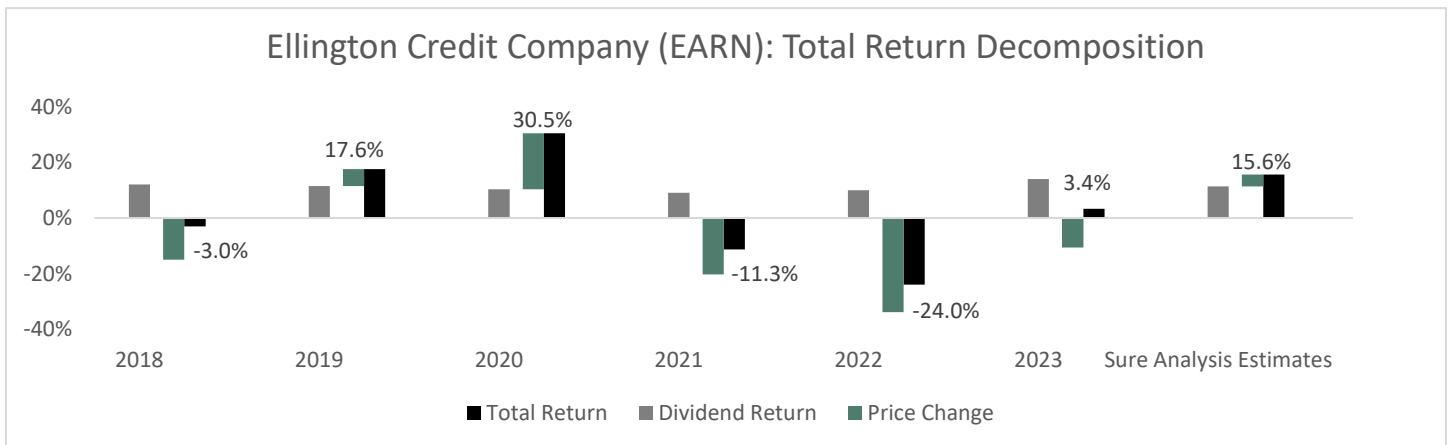
| Year | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2029 |
|--------|------|------|------|------|------|------|------|------|------|------|------|------|
| Payout | 72% | 83% | 96% | 82% | 108% | 130% | 89% | 93% | 98% | 112% | 81% | 74% |

EARN's dividend is far from trustworthy given the corporation has a trail of cuts in the rearview. In five of the last ten years, 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 its analytics have been developed over the company's 29-year history. The company possesses advanced proprietary models for prepayments and credit analysis. Also, approximately 20% 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. Its 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 Credit has a poor historical 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 15.6% in the intermediate term, driven almost entirely by the stock's 14.3% yield. We also assume a 2.0% annual adjusted distributable earnings growth rate and a 4.2% valuation tailwind. Ellington Credit 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 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|----------------|-------|------|------|-------|------|------|-------|-------|------|------|
| Revenue | 22 | 5 | 17 | 16 | (6) | 28 | 26 | (1) | -25 | 10 |
| SG&A Exp. | 3 | 3 | 3 | 4 | 3 | 3 | 3 | 4 | 1 | 1 |
| Net Profit | 16 | 0 | 12 | 11 | (11) | 22 | 20 | (6) | -30 | 5 |
| Net Margin | 73.8% | 0.6% | 70% | 65.4% | 195% | 80% | 77.5% | 1132% | 121% | 50% |
| Free Cash Flow | 21 | 25 | 20 | 34 | 29 | 18 | 24 | 28 | 22 | -10 |

Balance Sheet Metrics

| Year | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|----------------------|-------|-------|-------|-------|-------|-------|-------|-------|------|------|
| Total Assets | 1,521 | 1,557 | 1,429 | 1,887 | 1,676 | 1,489 | 1,195 | 1,598 | 1054 | 946 |
| Cash & Equivalents | 45 | 40 | 34 | 56 | 19 | 35 | 58 | 69 | 35 | 39 |
| Accounts Receivable | 5 | 4 | 5 | 6 | 6 | 5 | 4 | 5 | 3 | 5 |
| Total Liabilities | 1,358 | 1,412 | 1,287 | 1,694 | 1,522 | 1,328 | 1,028 | 1,444 | 941 | 809 |
| Accounts Payable | 1 | 2 | 3 | 4 | 6 | 4 | 2 | 3 | 50 | 57 |
| Shareholder's Equity | 163 | 145 | 142 | 193 | 154 | 161 | 166 | 154 | 112 | 136 |

Profitability & Per Share Metrics

| Year | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|------------------|------|------|------|------|--------|-------|-------|-------|--------|-------|
| Return on Assets | 1.1% | 0.0% | 0.8% | 0.7% | -0.6% | 1.4% | 1.5% | -0.5% | -2.3% | 0.5% |
| Return on Equity | 9.8% | 0.0% | 8.3% | 6.5% | -6.5% | 14.1% | 12.3% | -3.9% | -22.7% | 3.7% |
| ROIC | 9.8% | 0.0% | 8.3% | 6.5% | -6.5% | 14.1% | 12.3% | -3.9% | -22.7% | 3.7% |
| Shares Out. | 9.1 | 9.1 | 9.1 | 11.6 | 12.8 | 12.5 | 12.4 | 12.7 | 13.16 | 14.88 |
| Revenue/Share | 2.40 | 0.57 | 1.85 | 1.42 | (0.45) | 2.21 | 2.10 | -0.04 | -1.90 | 0.68 |
| FCF/Share | 2.33 | 2.71 | 2.18 | 2.97 | 2.25 | 1.41 | 1.97 | 2.20 | 1.70 | -0.67 |

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

Disclaimer

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