



# AGNC Investment Corporation (AGNC)

Updated April 2<sup>nd</sup>, 2019 by Samuel Smith

## Key Metrics

|                             |       |  |       |                                 |       |
|-----------------------------|-------|--|-------|---------------------------------|-------|
| <b>Current Price:</b>       | \$18  | <b>5 Year CAGR Estimate:</b>               | 12.3% | <b>Volatility Percentile:</b>   | 1.3%  |
| <b>Fair Value Price:</b>    | \$18  | <b>5 Year Growth Estimate:</b>             | 0.4%  | <b>Momentum Percentile:</b>     | 46.9% |
| <b>% Fair Value:</b>        | 100%  | <b>5 Year Valuation Multiple Estimate:</b> | 0.0%  | <b>Growth Percentile:</b>       | 2.4%  |
| <b>Dividend Yield:</b>      | 11.9% | <b>5 Year Price Target</b>                 | \$18  | <b>Valuation Percentile:</b>    | 53.2% |
| <b>Dividend Risk Score:</b> | D     | <b>Retirement Suitability Score:</b>       | B     | <b>Total Return Percentile:</b> | 75.4% |

## Overview & Current Events

American Capital Agency Corp was founded in 2008 and is a mortgage real estate investment trust that invests primarily in agency mortgage-backed securities (or MBS) on a leveraged basis. The firm's asset portfolio is comprised of residential mortgage pass-through securities, collateralized mortgage obligations (or CMO), and non-agency MBS. Many of these are guaranteed by government-sponsored enterprises. The majority of American Capital's investments are fixed-rate agency MBS. Most of these are MBS with a 30-year maturity period. The counterparties to most of American Capital's assets are located in North America. Counterparties in Europe also represent a significant percentage of the company's total portfolio. American Capital derives nearly all its revenue in the form of interest income. It currently generates about \$229 million in annual revenue and trades at a market cap of \$9.7 billion.

AGNC reported its Q4 and FY18 results on January 30<sup>th</sup> and results were not particularly good. The company suffered a comprehensive loss of \$0.90 per share and a -5.0% economic return on tangible common equity during Q4, working in tandem with significant spread widening on Agency mortgage-backed securities and increases in interest rate volatility to reduce its book value by 8% sequentially from the previous quarter. This led to a full year comprehensive loss of \$1.14 per share (due to an unrealized \$1.35 loss on investments marked-to-market and \$0.21 of net realized income per share) and a -4.9% economic return on tangible common equity.

## Growth on a Per-Share Basis

| Year          | 2009   | 2010   | 2011   | 2012   | 2013   | 2014     | 2015   | 2016   | 2017   | 2018   | 2019          | 2024          |
|---------------|--------|--------|--------|--------|--------|----------|--------|--------|--------|--------|---------------|---------------|
| <b>EPS</b>    | \$6.78 | \$7.89 | \$5.02 | \$4.17 | \$3.28 | (\$0.72) | \$0.54 | \$1.79 | \$2.04 | \$0.21 | <b>\$2.26</b> | <b>\$2.30</b> |
| <b>DPS</b>    | \$5.15 | \$5.60 | \$5.60 | \$5.00 | \$3.75 | \$2.61   | \$2.48 | \$2.30 | \$2.16 | \$2.16 | <b>\$2.16</b> | <b>\$2.16</b> |
| <b>Shares</b> | 18.0   | 37.0   | 153.0  | 303.0  | 379.0  | 353.0    | 349.0  | 331.0  | 358.0  | 441.0  | <b>162.8</b>  | <b>162.8</b>  |

Due to AGNC's heavily leveraged business model and its high sensitivity to interest rates, its results have been very choppy over the years. That being said, we believe that the current lower interest rate environment stemming from slowing global growth and the Federal Reserve's renewed dovish stance should enable them to have a strong bounce-back year from 2018 as it will keep spreads attractive and the mortgage market solid. Over the long-term we think they will gradually grow earnings (~0.4% annually), but their high payout ratio and the volatile nature of their business model will prevent them from growing quickly. We also believe that dividend growth will be halted for the foreseeable future as the company strives to grow its way back towards adequate coverage of its payout.

## Valuation Analysis

| Year             | 2009  | 2010  | 2011  | 2012  | 2013  | 2014  | 2015  | 2016  | 2017  | 2018  | Now          | 2024         |
|------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|--------------|--------------|
| <b>Avg. P/E</b>  | 4.0   | 3.6   | 5.6   | 7.1   | 5.9   | -30.4 | 31.8  | 10.1  | 9.9   | 83.6  | <b>8.0</b>   | <b>8.0</b>   |
| <b>Avg. Yld.</b> | 19.2% | 19.5% | 19.8% | 16.9% | 19.4% | 11.9% | 14.4% | 12.7% | 10.7% | 12.3% | <b>11.9%</b> | <b>11.7%</b> |

AGNC is currently trading at 8 times its projected 2019 EPS and we consider this to be a fair value based on its longer term P/E averages and current low growth prospects. As a result, we do not foresee much valuation multiple change at

*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.*



# AGNC Investment Corporation (AGNC)

Updated April 2<sup>nd</sup>, 2019 by Samuel Smith

all over the next half decade. We also believe that the dividend yield adequately compensates investors for the risk in the business model, but is certainly not cheap given that it is low relative to recent history.

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

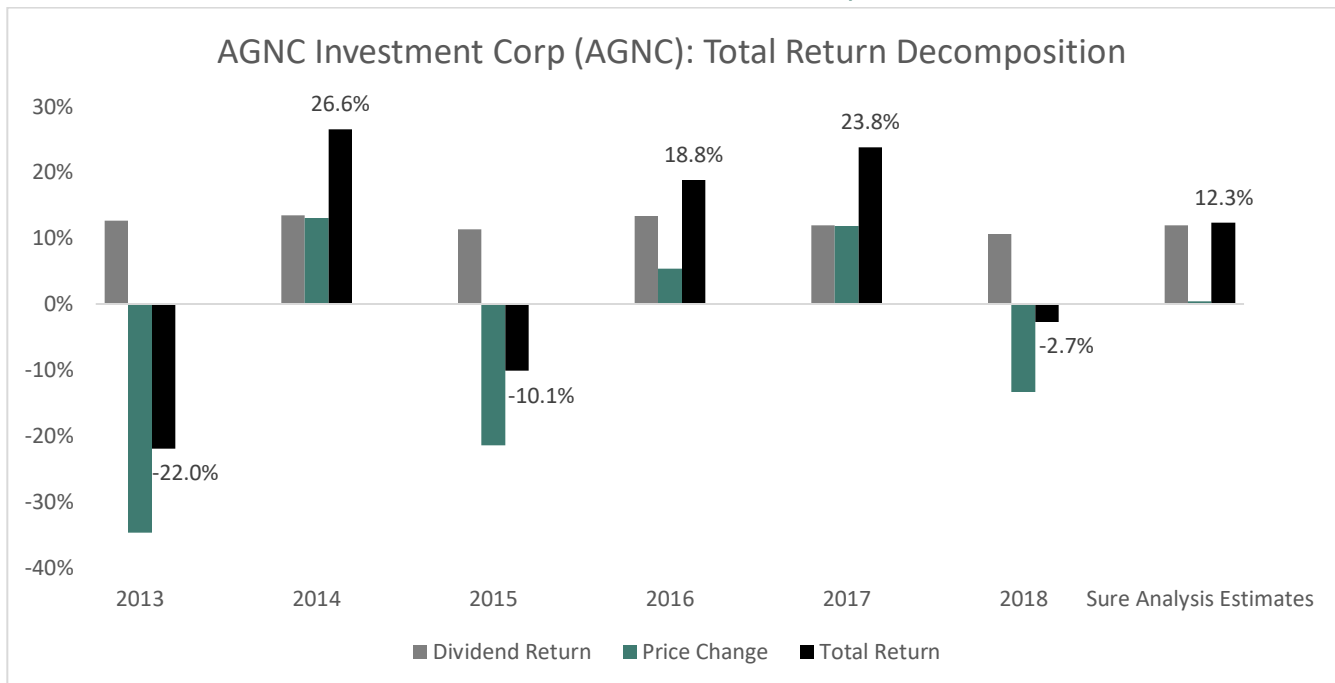
| Year   | 2009  | 2010  | 2011 | 2012 | 2013 | 2014  | 2015 | 2016 | 2017 | 2018  | 2019 | 2024 |
|--------|-------|-------|------|------|------|-------|------|------|------|-------|------|------|
| Payout | 76.0% | 71.0% | 112% | 120% | 114% | -363% | 459% | 129% | 106% | 1029% | 96%  | 94%  |

Given that it had its IPO in 2008 – in the midst of the financial crisis – it is hard to get an accurate picture of exactly how it can be expected to perform in the next recession. However, the mortgage backed security industry – given its leverage and interest rate sensitivity – is very prone to underperform when the housing market experiences a downturn and mortgage foreclosures rise. As a result, it should not be viewed as a safe defensive stock. That being said, its record thus far has been fairly strong, with industry-leading total economic return (NAV-based) and total stock return (share price-based). This outperformance has been driven by its highly efficient operating cost structure of approximately 0.8% of total equity capital and the competitive advantage that it enjoys through economies of scale as one of only three residential mortgage REITs with a market cap above \$5 billion. The company also strives to guard against downside and enhance shareholder total returns by utilizing a comprehensive risk management framework that is predicated on careful asset selection, disciplined hedging, and diversified funding.

## Final Thoughts & Recommendation

We think investors will experience total annualized returns of 12.3% over the coming half decade thanks to expected 0.4% annual earnings per share growth and the 11.9% dividend yield. While the stock has exciting total return potential, it remains a high risk security due to its highly leveraged business model that has high sensitivity to interest rates and the housing markets and the fact that its dividend has seen steady declines over time. We believe that EPS will rebound this year due to stable performance in the mortgage markets and low interest rates. However, if it fails to do so, the dividend may have to be cut again, which will significantly reduce our total return projection. AGNC is a speculative buy for higher risk tolerant investors looking for an attractive yield.

## Total Return Breakdown by Year



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.



# AGNC Investment Corporation (AGNC)

Updated April 2<sup>nd</sup>, 2019 by Samuel Smith

## Income Statement Metrics

| Year                  | 2009  | 2010  | 2011  | 2012  | 2013  | 2014 | 2015  | 2016  | 2017  | 2018  |
|-----------------------|-------|-------|-------|-------|-------|------|-------|-------|-------|-------|
| <b>Revenue</b>        | 130   | 307   | 850   | 1440  | 1440  | -92  | 354   | 728   | 844   | 229   |
| <b>SG&amp;A Exp.</b>  | 11    | 19    | 74    | 144   | 168   | 119  | 116   | 71    | 42    | 45    |
| <b>D&amp;A Exp.</b>   | N/A   | N/A   | N/A   | N/A   | N/A   | 0    | 0     | 2     | 3     | 25    |
| <b>Net Profit</b>     | 119   | 288   | 770   | 1277  | 1259  | -233 | 215   | 623   | 771   | 129   |
| <b>Net Margin</b>     | 91.2% | 93.8% | 90.6% | 88.7% | 87.4% | 253% | 60.7% | 85.6% | 91.4% | 56.3% |
| <b>Free Cash Flow</b> | 93    | 233   | 1070  | 2321  | 2501  | 1622 | 1428  | 1352  | 1260  | 1113  |

## Balance Sheet Metrics

| Year                          | 2009 | 2010  | 2011  | 2012  | 2013  | 2014  | 2015  | 2016  | 2017  | 2018   |
|-------------------------------|------|-------|-------|-------|-------|-------|-------|-------|-------|--------|
| <b>Total Assets</b>           | 4626 | 14476 | 57972 | 100B  | 76255 | 67766 | 57021 | 56880 | 70376 | 109241 |
| <b>Cash &amp; Equivalents</b> | 203  | 173   | 1367  | 2430  | 2143  | 1720  | 1110  | 1208  | 1046  | 921    |
| <b>Goodwill &amp; Int.</b>    |      |       |       |       |       |       | 0     | 554   | 551   | 526    |
| <b>Total Liabilities</b>      | 4079 | 12904 | 51760 | 89557 | 67558 | 58338 | 49050 | 49524 | 61622 | 99335  |
| <b>Accounts Payable</b>       | 180  | 727   | 40    | 132   | 492   | 100   | 61    | 211   | 299   | 518    |
| <b>Long-Term Debt</b>         | 0    | 73    | 54    | 937   | 910   | 761   | 4348  | 3497  | 357   | 275    |
| <b>Total Equity</b>           | 547  | 1572  | 6212  | 10729 | 8530  | 9092  | 7635  | 7020  | 8270  | 9422   |
| <b>D/E Ratio</b>              | 0.00 | 0.05  | 0.01  | 0.09  | 0.10  | 0.08  | 0.55  | 0.48  | 0.04  | 0.03   |

## Profitability & Per Share Metrics

| Year                    | 2009  | 2010  | 2011  | 2012  | 2013  | 2014  | 2015  | 2016  | 2017  | 2018  |
|-------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| <b>Return on Assets</b> | 3.8%  | 3.0%  | 2.1%  | 1.6%  | 1.4%  | -0.3% | 0.3%  | 1.1%  | 1.2%  | 0.1%  |
| <b>Return on Equity</b> | 29.5% | 27.2% | 19.8% | 15.1% | 13.1% | -2.6% | 2.6%  | 8.5%  | 10.1% | 1.5%  |
| <b>ROIC</b>             | 29.5% | 26.3% | 19.5% | 14.1% | 11.7% | -2.4% | 1.9%  | 5.4%  | 7.7%  | 1.3%  |
| <b>Shares Out.</b>      | 18.0  | 37.0  | 153.0 | 303.0 | 379.0 | 353.0 | 349.0 | 331.0 | 358.0 | 441.0 |
| <b>Revenue/Share</b>    | 7.43  | 8.41  | 5.54  | 4.74  | 3.80  | -0.26 | 1.02  | 2.19  | 2.35  | 0.52  |
| <b>FCF/Share</b>        | 5.33  | 6.38  | 6.98  | 7.64  | 6.60  | 4.59  | 4.10  | 4.07  | 3.51  | 2.52  |

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

### Disclaimer

Nothing presented herein is, or is intended to constitute, specific investment advice. Nothing in this research report should be construed as a recommendation to follow any investment strategy or allocation. Any forward-looking statements or forecasts are based on assumptions and actual results are expected to vary from any such statements or forecasts. No reliance should be placed on any such statements or forecasts when making any investment decision. While Sure Dividend has used reasonable efforts to obtain information from reliable sources, we make no representations or warranties as to the accuracy, reliability or completeness of third-party information presented herein. No guarantee of investment performance is being provided and no inference to the contrary should be made. There is a risk of loss from an investment in marketable securities. Past performance is not a guarantee of future performance.