



AGNC Investment Corp. (AGNC)

Updated September 24th, 2019 by Samuel Smith

Key Metrics

Current Price:	\$16	5 Year CAGR Estimate:	12.8%	Volatility Percentile:	2.8%
Fair Value Price:	\$18	5 Year Growth Estimate:	0.4%	Momentum Percentile:	39.4%
% Fair Value:	88%	5 Year Valuation Multiple Estimate:	2.4%	Growth Percentile:	4.5%
Dividend Yield:	13.5%	5 Year Price Target	\$18	Valuation Percentile:	78.3%
Dividend Risk Score:	F	Retirement Suitability Score:	B	Total Return Percentile:	86.7%

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 trust'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 capitalization of \$8.8 billion.

AGNC reported at the end of August that its tangible net book value was \$16.25 per share, adjusting for the \$0.16 deduction for the August dividend. This was down substantially from the net book value per share of \$17.16 at the end of July.

The trust reported Q2 results on July 24th. Net spread and dollar roll income per common share for the quarter (excluding estimated catch-up premium amortization cost) of \$0.49. This was down 5.8% year-over-year, reflecting the negative impacts of elevated MBS repo funding rates, as well as increased amortization expense stemming from higher projected lifetime prepayments speeds. While the trend is not encouraging, management is optimistic that results will stabilize as the rapid growth in prepayments is simply the result of the dramatic drop in interest rates.

During the quarter the trust achieved a -0.9% economic return on tangible common equity and held a \$104.4 billion investment portfolio at quarter end, comprised of \$91.6 billion in Agency MBS, a \$11.2 billion TBA mortgage position, and \$1.7 billion in credit risk transfer and non-Agency securities.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	\$6.78	\$7.89	\$5.02	\$4.17	\$3.28	(\$0.72)	\$0.54	\$1.79	\$2.04	\$0.21	\$2.26	\$2.30
DPS	\$5.15	\$5.60	\$5.60	\$5.00	\$3.75	\$2.61	\$2.48	\$2.30	\$2.16	\$2.16	\$2.16	\$2.16
Shares¹	18.0	37.0	153.0	303.0	379.0	353.0	349.0	331.0	358.0	441.0	162.8	162.8

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 its will gradually grow earnings (~0.4% annually), but the 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 trust strives to grow its way back towards adequate coverage of its payout.

¹ Share count in millions

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.



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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	4.0	3.6	5.6	7.1	5.9	-30.4	31.8	10.1	9.9	83.6	7.1	8.0
Avg. Yld.	19.2%	19.5%	19.8%	16.9%	19.4%	11.9%	14.4%	12.7%	10.7%	12.3%	13.5%	11.7%

AGNC is currently trading at 7.1 times its projected 2019 earnings-per-share and we consider this to be under a fair value of 8 times earnings based on its longer-term P/E averages and current low growth prospects. As a result, we foresee slight (2.4%) annual valuation multiple expansion over the next half decade. We also believe that the dividend yield adequately compensates investors for the risk in the business model.

Safety, Quality, Competitive Advantage, & Recession Resiliency

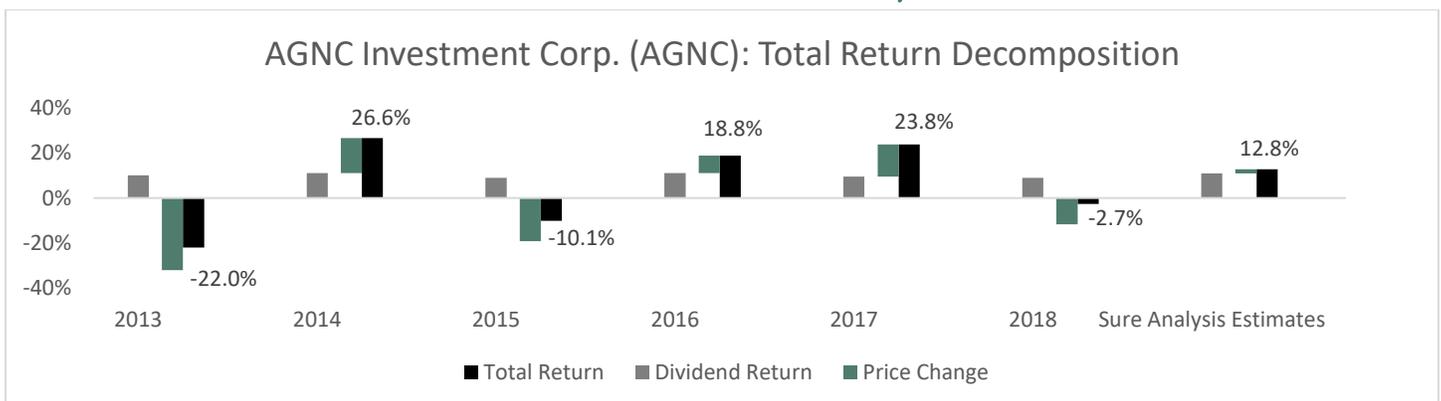
Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	76%	71%	112%	120%	114%	-363%	459%	129%	106%	1029%	96%	94%

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 capitalization above \$5 billion. The trust 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 12.8% over the coming half decade thanks to the strong 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 earnings 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. We view AGNC as a speculative buy for risk tolerant investors.

Total Return Breakdown by Year



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Income Statement Metrics

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

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	4626	14476	57972	100B	76255	67766	57021	56880	70376	109241
Cash & Equivalents	203	173	1367	2430	2143	1720	1110	1208	1046	921
Goodwill & Int.							0	554	551	526
Total Liabilities	4079	12904	51760	89557	67558	58338	49050	49524	61622	99335
Accounts Payable	180	727	40	132	492	100	61	211	299	518
Long-Term Debt	0	73	54	937	910	761	4348	3497	357	275
Total Equity	547	1572	6212	10729	8530	9092	7635	7020	8270	9422
D/E Ratio	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
Return on Assets	3.8%	3.0%	2.1%	1.6%	1.4%	-0.3%	0.3%	1.1%	1.2%	0.1%
Return on Equity	29.5%	27.2%	19.8%	15.1%	13.1%	-2.6%	2.6%	8.5%	10.1%	1.5%
ROIC	29.5%	26.3%	19.5%	14.1%	11.7%	-2.4%	1.9%	5.4%	7.7%	1.3%
Shares Out.	18.0	37.0	153.0	303.0	379.0	353.0	349.0	331.0	358.0	441.0
Revenue/Share	7.43	8.41	5.54	4.74	3.80	-0.26	1.02	2.19	2.35	0.52
FCF/Share	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.

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