



ARMOUR Residential REIT, Inc. (ARR)

Updated May 15th, 2021 by Samuel Smith

Key Metrics

Current Price:	\$11.7	5 Year CAGR Estimate:	4.1%	Market Cap:	\$864.2M
Fair Value Price:	\$8.5	5 Year Growth Estimate:	0.5%	Ex-Dividend Date:	5/14/21
% Fair Value:	137%	5 Year Valuation Multiple Estimate:	-6.1	Dividend Payment Date:	5/27/21
Dividend Yield:	10.3%	5 Year Price Target	\$9.0	Years Of Dividend Growth:	0
Dividend Risk Score:	F	Retirement Suitability Score:	C	Last Dividend Increase:	NA

Overview & Current Events

ARMOUR Residential (ARR) is a mortgage REIT that was formed in 2008. The trust invests primarily in residential mortgage-backed securities that are guaranteed or issued by a United States government entity including Fannie Mae, Freddie Mac and Ginnie Mae. ARMOUR has a \$864 million market capitalization and produces about \$392 million in net revenues.

ARMOUR reported Q1 results on April 21st, 2021. The trust's liquidity including cash and unencumbered securities amounted to \$687 million with \$12.40 in book value per common share at quarter end. Core income in Q1 fell from 32 cents in Q4 2020 to 23 cents per common share with comprehensive income at \$29.1 million, down from \$60.0 million sequentially. ARMOUR also reported debt-to-equity ratio of 4.2-to-1 compared with 4.8-to-1 at March 30.

Its securities portfolio included \$7.7 billion of agency MBS and includes TBA securities. Meanwhile, comprehensive income stood at \$29.1 million, representing 12% annualized return based on stockholder's equity at the beginning of the quarter.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
EPS	\$15.38	\$12.26	\$8.14	\$7.06	\$5.57	-\$5.54	\$2.78	\$2.59	\$2.54	\$1.29	\$1.22	\$1.25
DPS	\$11.28	\$9.60	\$6.48	\$4.80	\$3.89	\$3.02	\$2.28	\$2.28	\$2.04	\$0.93	\$1.20	\$1.05
Shares¹	8	28	45	45	43	37	40	44	59	65	70	90

ARMOUR's cash flow has been volatile since its inception in 2008, but this is to be expected with all mREITs. Of late, a shrinking balance sheet and declining spreads have crimped the trust's ability to produce cash flow.

That being said, the economic disruption caused by the coronavirus outbreak has disrupted the business model, leading to a sharp decline in cash flow per share, as well as a steep dividend cut. Moving forward, we expect the low interest rate environment and heavy government stimulus to enable the company to resume growth, though it will likely take a while for them to rebuild to previous levels of book value and earnings power.

Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	3.7	4.2	3.9	4.2	3.9	---	9.3	8.6	6.7	7.7	9.6	7.0
Avg. Yld.	19.8%	18.6%	20.4%	16.2%	17.9%	13.9%	8.8%	10.2%	12.0%	9.4%	10.2%	12.0%

As one would expect, ARMOUR's valuation has moved around a lot in recent years. With cash flow declining of late, the valuation has moved significantly higher. Given the current uncertainty facing the sector and the economy as a whole, we have reduced fair value further to 7 times cash flow. The company's current price to cash flow is considered overvalued. Given that shares trade above that level based on expectation for this year's cash flow per share, we expect multiple contraction over the coming years, providing a headwind to total returns.

¹ 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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Safety, Quality, Competitive Advantage, & Recession Resiliency

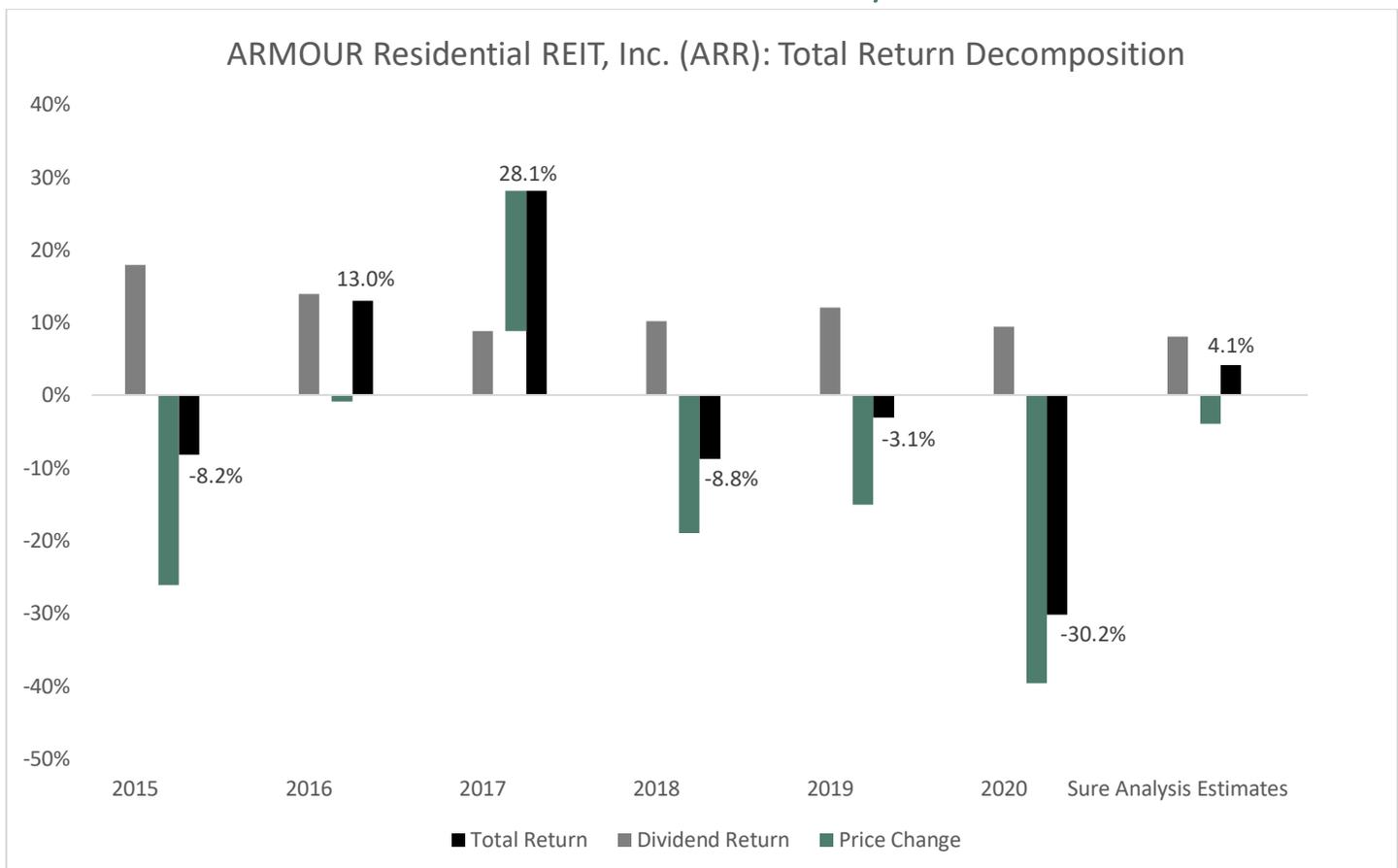
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Payout	73%	78%	80%	68%	70%	---	82%	88%	80%	72%	98%	84%

ARMOUR’s quality metrics have been volatile given the performance of the trust as rates have moved around over the years. Gross margins have moved down since short-term rates began to rise meaningfully a couple of years ago, although it appears most of that damage has been done. Balance sheet leverage had been moving down slightly, but it saw an uptick again this past quarter. However, we do not forecast significant movement in either direction from this point. Interest coverage has declined with spreads but also appears to have stabilized, so we are somewhat optimistic moving forward, while keeping in mind the significant potential for volatility. ARMOUR is facing headwinds from the coronavirus outbreak and an overall economic downturn. As a result, a steep dividend cut was necessary to preserve the balance sheet and allow the REIT to reposition itself for survival and future growth.

Final Thoughts & Recommendation

We see 4.1% annualized total returns for shareholders in the coming years thanks to the attractive dividend yield of 10.2% being partially offset by multiple contraction. ARMOUR has endured some tough times in the past but with prudent leverage and a management team that does not chase unprofitable growth, it appears the company should be able to weather its uncertain future. But due to weak projected returns, we rate it as a sell, and reiterate the inherent risks with mREITs.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	118	389	505	451	365	264	254	283	(211)	(182)
SG&A Exp.	9	24	35	35	33	38	36	37	34	36
Net Profit	-9	222	-187	-179	-31	-46	181	-106	(250)	(215)
Net Margin	-8.0%	57.1%	-37.0%	-39.7%	-8.5%	-17.2%	71.2%	-37.4%	118%	118%
Free Cash Flow	118	344	369	315	238	-203	110	75	(41)	(258)

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	6208	20879	15733	16286	13055	7978	8929	8465	13272	5,524
Cash & Equivalents	252	771	496	495	290	272	265	222	181	168
Acc. Receivable	395	684	0	261	0	N/A	N/A	N/A	35	13
Total Liabilities	5581	18571	13831	14537	11830	6886	7603	7339	11836	4,586
Accounts Payable	121	4	183	462	19	7	3	4	36	4
Long-Term Debt	0	0	0	0	0	0	0	0	-	-
Total Equity	627	2308	1901	1749	1225	1092	1326	1125	1,437	938

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	-0.3%	1.6%	-1.0%	-1.1%	-0.2%	-0.4%	2.1%	-1.2%	-2.3%	-2.3%
Return on Equity	-2.6%	15.2%	-8.9%	-9.8%	-2.1%	-3.9%	15.0%	-8.6%	-19.5%	-18.1%
ROIC	-2.6%	15.2%	-8.9%	-9.8%	-2.1%	-3.9%	15.0%	-8.6%	-19.5%	-18.1%
Shares Out.	8	28	45	45	43	37	40	44	59	65
Revenue/Share	15.32	13.88	11.14	10.10	8.54	7.19	6.42	6.72	(3.66)	(2.89)
FCF/Share	15.38	12.26	8.14	7.06	5.57	-5.54	2.78	1.79	(0.70)	(4.09)

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

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