



Annaly Capital Management (NLY)

Updated March 1st, 2022 by Samuel Smith

Key Metrics

Current Price:	\$7	5 Year CAGR Estimate:	12.2%	Market Cap:	\$10.3B
Fair Value Price:	\$7	5 Year Growth Estimate:	1.7%	Ex-Dividend Date:	03/30/22 ¹
% Fair Value:	99%	5 Year Valuation Multiple Estimate:	0.3%	Dividend Payment Date:	05/01/22 ²
Dividend Yield:	12.6%	5 Year Price Target	\$8.00	Years of Dividend Growth:	0
Dividend Risk Score:	F	Retirement Suitability Score:	C	Last Dividend Increase:	NA

Overview & Current Events

Annaly Capital Management, Inc., a diversified capital manager, invests in and finances residential and commercial assets. The trust invests in various types of agency mortgage-backed securities, non-agency residential mortgage assets, and residential mortgage loans. It also originates and invests in commercial mortgage loans, securities, and other commercial real estate investments. Annaly provides financing to private equity-backed middle market businesses and operates as a broker-dealer. The trust has elected to be taxed as a real estate investment trust (REIT). As a REIT, it is not subject to federal income tax to the extent that it distributes its taxable income to its shareholders. Annaly Capital Management, Inc. was founded in 1996 and is based in New York, New York.

Q4 results were reported on February 9th. Annaly reported GAAP net income of \$0.27 per average common share for the quarter. Earnings available for distribution came in at \$0.28. Economic leverage stood at 5.7x, down from 5.8x sequentially. Book value per common share decreased to \$7.97 from \$8.39 sequentially.

Net interest margin, excluding PAA, stood at 2.03% against 1.98% year-over-year while Q4 net interest spread, excluding PAA, stood at 1.88%, down from 1.93% in the year-ago period. Total assets in Q4 stood at \$89.2 billion including \$81.5 billion in highly liquid Agency portfolio. Meanwhile, the company reported a -2.4% quarterly economic return and tangible economic return in Q4. The company also reported 12.4% of annualized GAAP return on average equity and 13.1% of annualized EAD return on average equity.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	\$1.79	\$3.94	-\$0.89	\$0.49	\$1.48	\$1.47	\$0.04	\$1.19	\$1.10	\$1.16	\$1.01	\$1.10
DPS	\$2.05	\$1.50	\$1.20	\$1.20	\$1.20	\$1.20	\$1.20	\$1.00	\$0.91	\$0.88	\$0.88	\$1.00
Shares³	947.3	947.5	947.7	924.8	1018.9	1159.6	1400.1	1430.3	1398.5	1459.7	1459.7	1800

Instability in the markets created valuation declines across the sector in late 2019 into 2020 as interest rate volatility put pressure on the bottom lines of mortgage REITs, revealing the cyclical nature of this investment vehicle. With increasing interest rates, Annaly saw a narrowing between interest income and expenses, as well requiring greater amounts of leverage to produce declining results.

The stock price has also continued to decline as additional shares have been issued to grow the capital base without the results transferring to the bottom line. Moving forward, the stabilization of interest rates could help them to catch up later this year. However, with interest rates still far below long-term averages, there will be pressure to continue increasing interest rates as the economy continues to grow, negatively impacting Annaly.

¹ Estimated date

² Estimated date

³ In millions

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Given lingering disruptive impacts from the coronavirus outbreak, we expect weak earnings per share growth to go along with management's precautionary dividend cut. Prepayments are a further risk given how low rates are and the outlook for likely higher rates in the near future, which drives refinance activity.

Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	7.86	2.53	---	19.02	6.74	8.08	220	8.0	6.9	7.7	6.9	7.0
Avg. Yld.	14.6%	15.0%	---	12.8%	12.0%	10.1%	13.6%	10.5%	11.9%	10.2%	12.6%	13.0%

The cyclical nature of this trust's earnings makes them difficult to value based on challenging years like 2018. We believe that the fair value P/E should be around 8 based on past performance, but current headwinds for the industry are causing us to reduce our estimate to 7 times earnings. As a result, we believe the stock is slightly undervalued at present based on expected 2022 results.

Safety, Quality, Competitive Advantage, & Recession Resiliency

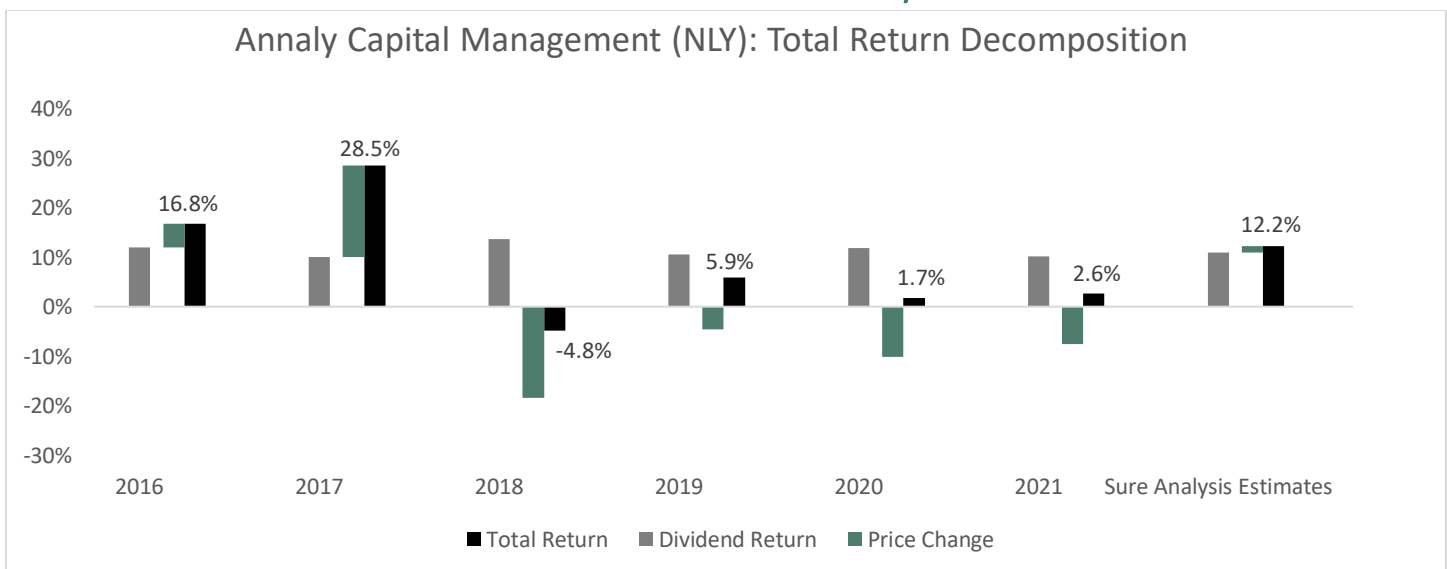
Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	115%	38%	-135%	245%	81%	82%	3000%	84%	83%	79%	87%	91%

The advantage Annaly has over some of its mortgage REIT competitors is diversification within their income stream, providing them the opportunity to pivot depending on the circumstance. That said, Annaly is very interest rate sensitive. Although it is less levered than others in the sector, we are concerned that Annaly is using more leverage to generate results and issuing additional shares to drive capital expansion, rather than growing based on increased profitability. With debt ratios rising and interest rates being currently stable, but with the potential to rise further, the payout ratio will almost surely remain very high.

Final Thoughts & Recommendation

With a total return outlook of 12.2% and a mouthwatering 12.6% dividend yield compensating for considerable uncertainty in its business model, we rate the stock a speculative Buy given the inherent risk involved in mREITs alongside the fantastic total return potential.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	2,169	3,997	(615)	734	1,565	1,684	275	(1,992)	(585)	2,662
SG&A Exp.	236	232	209	200	250	224	330	272	222	186
D&A Exp.	4	3	5	20	42	28	72	32	41	25
Net Profit	1,736	3,730	(842)	467	1,434	1,570	54	(2,163)	(891)	2,390
Net Margin	80.0%	93.3%	136.9%	63.5%	91.6%	93.2%	19.8%	108.6%	152.4%	89.8%
Free Cash Flow	7,640	-12,893	6,128	(3,643)	1,407	1,621	2,622	(1,200)	528	2,539
Income Tax	36	8	5	(2)	(2)	7	(2)	(11)	(28)	5

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets (\$B)	133	82	88	75	88	102	106	130	88	77
Cash & Equivalents	616	552	1,741	1,769	1,540	707	1,736	1,851	1,244	1,342
Acc. Receivable	419	273	278	231	270	325	426	455	284	238
Goodwill & Int.	62	95	133	110	758	676	659	471	228	638
Total Liabilities (\$B)	118	70	75	63	75	87	92	114	74	64
Accounts Payable	198	186	228	205	347	910	1,154	940	1,075	239
Long-Term Debt	826	859	1,266	4,734	7,865	7,119	8,041	10,564	7,036	7,108
Total Equity	15,011	11,492	12,415	10,983	11,368	13,145	12,334	13,810	12,472	11,633
LTD/E Ratio	0.05	0.07	0.10	0.40	0.63	0.48	0.57	0.67	0.50	0.54

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	0.4%	1.4%	3.5%	-1.0%	0.6%	1.8%	1.7%	0.1%	-1.8%	-0.8%
Return on Equity	2.7%	11.3%	28.1%	-7.0%	4.0%	12.8%	12.8%	0.4%	-16.5%	-6.8%
ROIC	2.6%	10.5%	24.9%	-6.0%	3.0%	7.7%	7.4%	0.2%	-8.9%	-3.8%
Shares Out.	874	972	947	947	947	969	1066	1210	1319	1430
Revenue/Share	0.73	2.16	4.01	-0.65	0.78	1.61	1.58	0.23	-1.39	-0.41
FCF/Share	2.76	7.60	-12.9	6.47	-3.85	1.45	1.52	-34.8	-45.1	-22.7

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

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