Dynex Capital Inc. (DX)

Updated April 28th, 2022 by Samuel Smith

Key Metrics

Current Price:	$16.4	**5 Year CAGR Estimate:**	6.2%	**Market Cap:**	$615 M
Fair Value Price:	$13.2	**5 Year Growth Estimate:**	1.8%	**Ex-Dividend Date:**	07/21/22[1]
% Fair Value:	124%	**5 Year Valuation Multiple Estimate:**	-4.2%	**Dividend Payment Date:**	08/02/22[2]
Dividend Yield:	9.5%	**5 Year Price Target**	$14	**Years of Dividend Growth:**	0
Dividend Risk Score:	F	**Retirement Suitability Score:**	C	**Rating:**	Hold

Overview & Current Events

Dynex Capital, Inc. was founded in 1987 and is headquartered in Glen Allen, Virginia. As an mREIT, Dynex Capital invests in mortgage-backed securities (MBS) on a leveraged basis in the United States. It invests in agency and non-agency MBS consisting of residential MBS, commercial MBS (CMBS), and CMBS interest-only securities. Agency MBS have a guaranty of principal payment by an agency of the U.S. government or a U.S. government-sponsored entity, such as Fannie Mae and Freddie Mac. Non-Agency MBS have no such guaranty of payment. The trust is structured to have internal management, which is good because it can reduce conflicts of interest and often leads to lower management expenses.

The trust reported first-quarter results on April 27th, 2022. Q1 earnings per share decreased to $0.44 from $0.45 in the year-ago period. Comprehensive income and net income stood at $0.65 and $3.14, respectively. Book value per share increased by $0.25 to $18.24 as of March 31, 2022.

Meanwhile, mortgage loans held for investment decreased to $3.76 billion from $4.27 billion in the year-ago period. Unrealized loss on investments stood at $111.3 million compared with a loss of $11.83 million year-over-year. The trust also reported 6.1x in leverage as of March 31, 2022 from 5.7x as of December 31, 2021.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	$4.05	$3.30	$1.02	$0.42	$2.07	$1.38	-$0.24	$2.16	$1.92	$1.97	***$1.65***	***$1.80***
DPS	$3.45	$3.36	$3.00	$2.88	$2.52	$2.16	$2.16	$2.01	$1.66	$1.56	***$1.56***	***$1.56***
Shares[3]	18	18	18	18	16	17	19	24	23	37	***37***	***40***

Given that interest rates are expected to remain in a narrower and lower range for a longer period than ever seen in history, growth will likely suffer substantially. This is because the global economy will continue to be weighed down by large pools of negative-yielding debt, forcing central banks to remain accommodative in their monetary policy. That being said, such a low yield environment creates an opportunity in high-quality real asset backed loans and Dynex still benefits from several long-term factors that could enable it to continue growing.

First, an aging population in a low-yield world should foster a growing demand for the cash flow that the business can generate, thereby boosting valuations and making attracting capital easier for mortgage REITs. Second, as the Federal Reserve attempts to reduce its investment in Agency RMBS and GSE reform opens new investment opportunities, demand for private capital in the US housing finance system should grow. Third, the shortage of affordable housing means that there is a need for additional investment into the sector. Taking into account these headwinds and tailwinds along with the trust's high payout ratio and the lingering headwinds from the coronavirus outbreak, we expect continued weak performance moving forward.

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[1] Estimate

[2] Estimate

[3] Share count in millions

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Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	9.0	7.25	12.0	40.0	9.5	15.0	NA	7.8	9.4	9.0	***9.9***	***8.0***
Avg. Yld.	9.5%	14.0%	24.5%	17.1%	12.8%	10.4%	---	11.9%	9.2%	8.9%	***9.5%***	***10.8%***

Due to lumpiness in earnings, it is difficult to establish an accurate price to earnings ratio from the past decade. Excluding the outliers in 2015 and 2018, we get an average earnings multiple of 10.4. However, we see that most years it has been between 7.0 and 10.0. Given that the company has a history of dividend cuts and growth prospects are poor, we do not believe that the multiple should be much higher than this. As a result, we believe that a multiple of around 8 times earnings is appropriate. If achieved over the next half decade, multiple contraction would provide a headwind to annual total returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	85.2%	102%	294%	686%	122%	157%	N/A	83%	81%	80%	***95%***	***87%***

Dynex brings to the table some competitive advantages, which could enable it to generate strong returns for investors throughout business cycles. These include the trust's experienced management team with expertise in managing securitized real estate assets through multiple economic cycles, as well as its emphasis on maintaining a diversified pool of highly liquid mortgage investments with minimal credit risk.

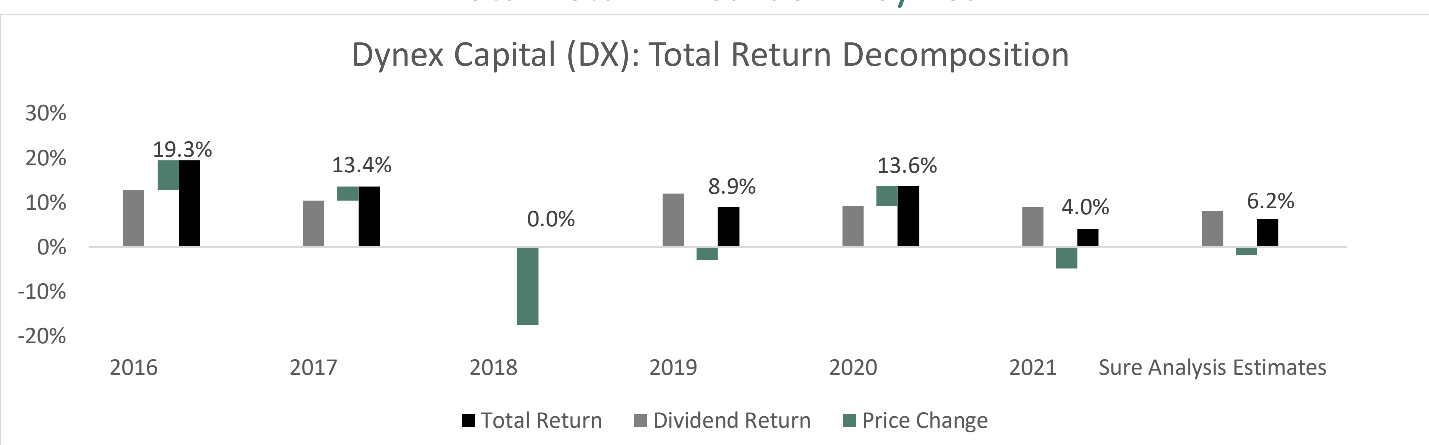
One of the biggest challenges is the shrinking spread between 3-month LIBOR and short-term repo rates, as repo rates remain elevated due to the Fed's pause on the Fed Funds rate. Another risk is that prepayment speeds could rise due to seasonal factors. Additionally, the fall in mortgage rates could increase refinancing activity, further cutting into profits.

The trust's normalized diluted earnings per share were actually quite stable through the last recession, though shares still sold off very heavily, losing about 40% of their market value. All in all, there's little margin of safety here due largely to the payout ratio being so high, combined with highly volatile earnings-per-share.

Final Thoughts & Recommendation

Looking ahead to the next half decade, we expect total annualized returns of 6.2%. Given the current headwinds facing the sector, we feel that these total returns are even less attractive on a risk-adjusted return basis. Therefore, we rate Dynex as a Hold despite its attractive dividend yield.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	86	81	43	34	57	50	24	(137)	200	128
SG&A Exp.	13	13	16	18	15	16	15	16	21	24
D&A Exp.	(1)	8	9	5	2	1	1	2	2	
Net Profit	74	68	28	17	43	34	7	(153)	178	102
Net Margin	86.1%	83.6%	65.3%	49.3%	75.8%	68.0%	29.6%	112%	88.9%	80.1%
Free Cash Flow	149	209	214	217	211	204	181	175	174	

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	4,280	4,217	3,688	3,670	3,398	3,306	3,886	5,371	3,088	3,693
Cash & Equivalents	56	69	44	34	74	41	35	63	296	366
Acc. Receivable	23	22	21	23	20	20	21	26	14	14
Total Liabilities	3,664	3,631	3,081	3,178	2,931	2,749	3,359	4,788	2,454	2,921
Accounts Payable	3	3	2	2	3	4	10	16	1	1
Long-Term Debt	31	13	11	528	6	6	3	3	0	-
Total Equity	561	476	498	382	357	416	384	420	459	663
LTD/E Ratio	0.05	0.02	0.02	1.07	0.01	0.01	0.01	0.00	0.00	-

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	2.2%	1.6%	0.7%	0.4%	1.2%	1.0%	0.2%	-3.3%	4.2%	3.0%
Return on Equity	15.9%	13.1%	5.7%	3.8%	11.7%	8.8%	1.8%	-38.0%	40.4%	18.2%
ROIC	13.6%	10.9%	4.6%	2.0%	5.8%	6.5%	1.3%	-27.4%	29.1%	14.6%
Shares Out.	18	18	18	18	16	17	19	24	23	37
Revenue/Share	4.85	4.47	2.33	1.90	3.47	2.97	1.23	(5.79)	8.64	3.90
FCF/Share	8.43	11.46	11.76	12.32	12.85	12.17	9.39	7.42	7.53	

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