



ARMOUR Residential REIT, Inc. (ARR)

Updated August 24th, 2022 by Samuel Smith

Key Metrics

Current Price:	\$7.2	5 Year CAGR Estimate:	14.1%	Market Cap:	\$832M
Fair Value Price:	\$7.9	5 Year Growth Estimate:	1.2%	Ex-Dividend Date:	8/12/23 ¹
% Fair Value:	91%	5 Year Valuation Multiple Estimate:	1.8%	Dividend Payment Date:	8/29/23 ²
Dividend Yield:	16.7%	5 Year Price Target	\$8.0	Years Of Dividend Growth:	1
Dividend Risk Score:	F	Retirement Suitability Score:	C	Rating:	Buy

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 \$832 million market capitalization and produces about \$160 million in net revenues.

ARMOUR reported Q2 results on July 27th, 2022. The trust's net interest income stood at \$35.0 million. Liquidity including cash and unencumbered securities amounted to \$573.7 million with \$7.25 in book value per common share at quarter end. Q2 distributable earnings per share increased 16.8% quarter-over-quarter to 29 cents while the debt-to-equity ratio stood at 6.9-to-1 and leverage, including TBA Securities stood at 7.6-1.

Meanwhile, net interest margin increased to 2.22%, up 44 basis points quarter-over-quarter. Portfolio composition was 92% agency mortgage-backed securities, including TBA securities. Comprehensive loss stood at \$(96.2) million, representing (10.7%) annualized return based on stockholder's equity at the beginning of the quarter. The trust also repurchased 248,000 shares of common stock at an average cost of \$6.23 per share. Finally, interest rate swap contracts amounted to \$6.9 billion which represents 94% of total repurchase agreement and TBA Securities liabilities.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
EPS	\$12.26	\$8.14	\$7.06	\$5.57	-\$5.54	\$2.78	\$2.59	\$2.54	\$1.29	\$0.96	\$1.13	\$1.20
DPS	\$9.60	\$6.48	\$4.80	\$3.89	\$3.02	\$2.28	\$2.28	\$2.04	\$0.93	\$1.20	\$1.20	\$1.05
Shares³	28	45	45	43	37	40	44	59	65	90	114.6	102

ARMOUR's cash flow has been volatile since its inception in 2008, but this is to be expected with all mREITs. Of late, declining spreads have hurt earnings while the economic disruption caused by the coronavirus outbreak disrupted the business model, leading to a sharp decline in cash flow per share, as well as a steep dividend cut. Fortunately, ARMOUR is now seeing a measure of recovery, and should continue to see that recovery manifest itself in the coming quarters and years.

Moving forward, we expect the reopening economy 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 given the low interest rate environment. We also expect the dividend to be cut as it is not covering the current payout with earnings.

Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	4.2	3.9	4.2	3.9	---	9.3	8.6	6.7	7.7	10.9	6.4	7.0
Avg. Yld.	18.6%	20.4%	16.2%	17.9%	13.9%	8.8%	10.2%	12.0%	9.4%	11.5%	16.7%	12.5%

¹ Estimate

² Estimate

³ 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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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 low spreads they are facing, we have reduced fair value further to 7 times cash flow. The company’s current price to cash flow is considered undervalued. Given that shares trade below that level based on expectation for this year’s cash flow per share, we expect multiple expansion over the coming years, providing a tailwind to total returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

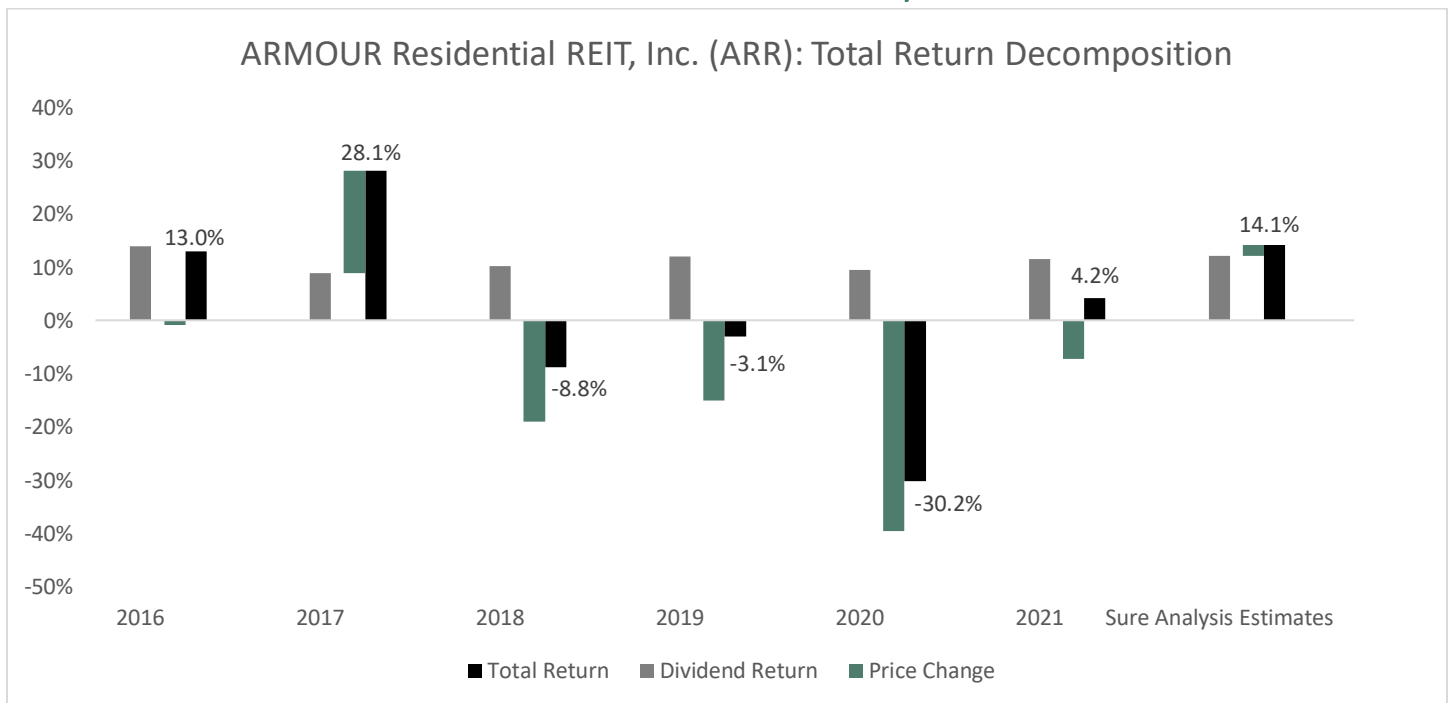
Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Payout	78%	80%	68%	70%	---	82%	88%	80%	72%	125%	107%	88%

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 faced 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 14.1% annualized total returns for shareholders in the coming years thanks to the attractive dividend yield of 16.7% being partially offset by an expected dividend cut. 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. Overall, we rate the stock a speculative Buy at the current price.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	389	505	451	365	264	254	283	(211)	(182)	19
SG&A Exp.	24	35	35	33	38	36	37	34	36	7
Net Profit	222	-187	-179	-31	-46	181	-106	(250)	(215)	15
Net Margin	57.1%	-37.0%	-39.7%	-8.5%	-17.2%	71.2%	-37.4%	118%	118%	80.1%
Free Cash Flow	344	369	315	238	-203	110	75	(41)	(258)	12

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	20879	15733	16286	13055	7978	8929	8465	13272	5,524	5,277
Cash & Equivalents	771	496	495	290	272	265	222	181	168	338
Acc. Receivable	684	0	261	0	N/A	N/A	N/A	35	13	10
Total Liabilities	18571	13831	14537	11830	6886	7603	7339	11836	4,586	4,134
Accounts Payable	4	183	462	19	7	3	4	36	4	4
Long-Term Debt	0	0	0	0	0	0	0	-	-	-
Total Equity	2308	1901	1749	1225	1092	1326	1125	1,437	938	-

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	1.6%	-1.0%	-1.1%	-0.2%	-0.4%	2.1%	-1.2%	-2.3%	-2.3%	0.3%
Return on Equity	15.2%	-8.9%	-9.8%	-2.1%	-3.9%	15.0%	-8.6%	-19.5%	-18.1%	1.5%
ROIC	15.2%	-8.9%	-9.8%	-2.1%	-3.9%	15.0%	-8.6%	-19.5%	-18.1%	1.5%
Shares Out.	28	45	45	43	37	40	44	59	65	90
Revenue/Share	13.88	11.14	10.10	8.54	7.19	6.42	6.72	(3.66)	(2.89)	0.24
FCF/Share	12.26	8.14	7.06	5.57	-5.54	2.78	1.79	(0.70)	(4.09)	0.15

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

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