ARMOUR Residential REIT, Inc. (ARR)

Updated October 28th, 2023 by Samuel Smith

Key Metrics

Current Price:	$13.7	**5 Year CAGR Estimate:**	12.5%	**Market Cap:**	$670M
Fair Value Price:	$23.4	**5 Year Growth Estimate:**	-15.6%	**Ex-Dividend Date:**	08/14/23
% Fair Value:	58%	**5 Year Valuation Multiple Estimate:**	11.3%	**Dividend Payment Date:**	08/30/23
Dividend Yield:	35.1%	**5 Year Price Target**	$10.0	**Years Of Dividend Growth:**	0
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 $670 million market capitalization.

On October 25, 2023, ARMOUR Residential REIT, Inc. (ARR) announced its Q3 2023 results and financial position as of September 30, 2023. Following a one-for-five reverse stock split completed on September 29, 2023, the company reported a loss of $(182.2) million or $(3.92) per common share. Net interest income stood at $3.6 million, and distributable earnings available to common stockholders were $50.2 million, equating to $1.08 per common share. The asset yield was 4.65%, and after deducting the net cost of funds of 2.92%, the net interest margin was 1.73%. During this period, ARR paid common stock dividends of $0.40 per share per month and raised $191.4 million of capital by issuing 7,628,578 common shares through at-the-market offerings.

As of September 30, 2023, the book value per common share was $21.73, a decrease from $26.90 on June 30, 2023, mainly due to the net loss per common share of (3.92) and common dividends per common share of (1.20). The company's liquidity, inclusive of cash and unencumbered agency and U.S. government securities, was $499.0 million. Its agency mortgage-backed securities (MBS) portfolio net of To Be Announced (TBA) Security positions totaled $12.0 billion, with repurchase agreements amounting to $11.5 billion, 50.1% of which were with ARMOUR affiliate BUCKLER Securities LLC. The debt-to-equity ratio was 9.3 to 1, and implied leverage was 8.9 to 1. Interest rate swap contracts totaled $8.3 billion of notional amount, representing 76% of total repurchase agreement and TBA Securities. Furthermore, on October 24, 2023, ARMOUR's board of directors authorized an increase to the current common stock repurchase authorization, allowing the company to repurchase up to an aggregate of 2,500,000 shares of the company's outstanding common stock, effective October 30, 2023.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	$8.14	$7.06	$5.57	-$5.54	$2.78	$2.59	$2.54	$1.29	$0.96	$1.16	***$4.68***	***$2.00***
DPS	$6.48	$4.80	$3.89	$3.02	$2.28	$2.28	$2.04	$0.93	$1.20	$1.20	***$4.80***	***$2.00***
Shares[1]	45	45	43	37	40	44	59	65	96	193	***49.0***	***55.0***

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 company to see earnings plummet in line with its historical pattern. The company's sky-high dividend payout will likely prove unsustainable as a result.

[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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Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	3.9	4.2	3.9	---	9.3	8.6	6.7	7.7	10.9	5.0	***2.9***	***5.0***
Avg. Yld.	20.4%	16.2%	17.9%	13.9%	8.8%	10.2%	12.0%	9.4%	11.5%	21.1%	***35.1%***	***20.0%***

As one would expect, ARMOUR's valuation has moved around a lot in recent years. Given the current uncertainty facing the sector and elevated interest rates, we have set fair value at 5 times cash flow. The company's current price to cash flow is considered significantly undervalued due to the weakness in the share price. Given that shares trade at a steep discount 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

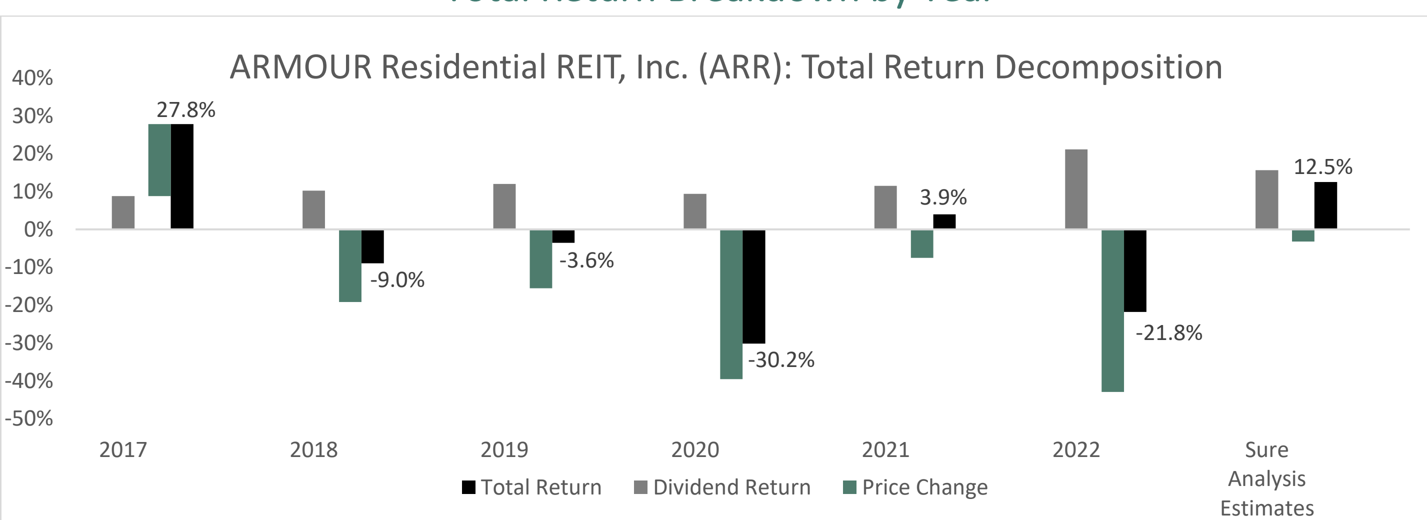
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	80%	68%	70%	-55%	82%	88%	80%	72%	125%	103%	**103%**	**100%**

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 12.5% annualized total returns for shareholders in the coming years thanks to the attractive dividend yield of 35.1% along with some expected valuation multiple expansion offset by significant expected declines in earnings per share. 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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	505	451	365	264	254	283	(211)	(182)	19	(226)
SG&A Exp.	35	35	33	38	36	37	34	36	7	5
Net Profit	-187	-179	-31	-46	181	-106	(250)	(215)	15	(230)
Net Margin	-37.0%	-39.7%	-8.5%	-17.2%	71.2%	-37.4%	118%	118%	80.1%	102%
Free Cash Flow	369	315	238	-203	110	75	(41)	(258)	12	124

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	15733	16286	13055	7978	8929	8465	13272	5,524	5,277	9,437
Cash & Equivalents	496	495	290	272	265	222	181	168	338	87
Acc. Receivable	0	261	0	N/A	N/A	N/A	35	13	11	29
Total Liabilities	13831	14537	11830	6886	7603	7339	11836	4,586	4,134	8,325
Accounts Payable	183	462	19	7	3	4	36	4	4	29
Long-Term Debt	0	0	0	0	0	0	-	-	-	-
Total Equity	1901	1749	1225	1092	1326	1125	1,437	938	1,144	1,112

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	-1.0%	-1.1%	-0.2%	-0.4%	2.1%	-1.2%	-2.3%	-2.3%	0.3%	-3.1%
Return on Equity	-8.9%	-9.8%	-2.1%	-3.9%	15.0%	-8.6%	-19.5%	-18.1%	1.5%	-20.4%
ROIC	-8.9%	-9.8%	-2.1%	-3.9%	15.0%	-8.6%	-19.5%	-18.1%	1.5%	-20.4%
Shares Out.	45	45	43	37	40	44	59	65	90	94
Revenue/Share	11.14	10.10	8.54	7.19	6.42	6.72	(3.66)	(2.89)	0.24	(1.91)
FCF/Share	8.14	7.06	5.57	-5.54	2.78	1.79	(0.70)	(4.09)	0.15	1.05

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