



Dynex Capital Inc. (DX)

Updated October 25th, 2023 by Samuel Smith

Key Metrics

Current Price:	\$10.0	5 Year CAGR Estimate:	7.0%	Market Cap:	\$566.1M
Fair Value Price:	\$8.0	5 Year Growth Estimate:	0.0%	Ex-Dividend Date:	10/25/23
% Fair Value:	125%	5 Year Valuation Multiple Estimate:	-4.4%	Dividend Payment Date:	11/01/23
Dividend Yield:	15.6%	5 Year Price Target	\$8	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.

Dynex Capital, Inc. reported its third quarter financial results on October 23rd, 2023. Dynex Capital reported a book value of \$12.25 and a comprehensive loss of \$1.59 for the third quarter. Influenced by rate increases and spread widening, the performance this quarter saw leverage rise to 8.5 turns from 7.7 turns in the previous quarter. While Dynex's Economic Adjusted Duration (EAD) doesn't factor in the benefits of hedging activities, the company predominantly uses futures as their primary hedging instrument due to their market depth, liquidity, and lower capital requirements. In Q3, Dynex recorded notable net hedge gains of \$217 million, with unamortized net hedge gains standing at \$830 million by the end of the quarter. The company also recognized \$18 million in hedge gain amortization for tax purposes, which translates to approximately \$0.33. These hedge gains are anticipated to bolster the dividend, with projections for Q4 hedge gains being \$24 million or \$0.41 per share. Dynex concluded the third quarter with an unrealized gain on its hedges.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	\$3.30	\$1.02	\$0.42	\$2.07	\$1.38	-\$0.24	\$2.16	\$1.92	\$1.97	\$1.04	(\$1.01)	\$1.00
DPS	\$3.36	\$3.00	\$2.88	\$2.52	\$2.16	\$2.16	\$2.01	\$1.66	\$1.56	\$1.56	\$1.56	\$1.00
Shares¹	18	18	18	16	17	19	24	23	37	53	54	42

With interest rates rising rapidly and the mortgage market currently suffering from plummeting demand, Dynex may have a challenging time growing. On top of that, a recession is considered increasingly likely, which in turn could lead to a jump in defaults on Dynex' investments, posing a further headwind to growth. As a result, when combined with Dynex' sky-high payout ratio, we are expecting earnings power to stagnate in the coming years, leading to a likely dividend cut. For the purpose of this article, we are assuming an earnings power of \$1 per share.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	9	7.25	12	40	9.5	15	NA	7.8	9.4	9.0	10.0	8.0
Avg. Yld.	9.5%	14.0%	24.5%	17.1%	12.8%	10.4%	13.0%	11.9%	9.2%	16.7%	15.6%	12.5%

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 see that in most years Dynex' price to earnings ratio 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

¹ Share count 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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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	102%	294%	686%	122%	157%	-900%	93%	86%	79%	150%	156%	100%

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.

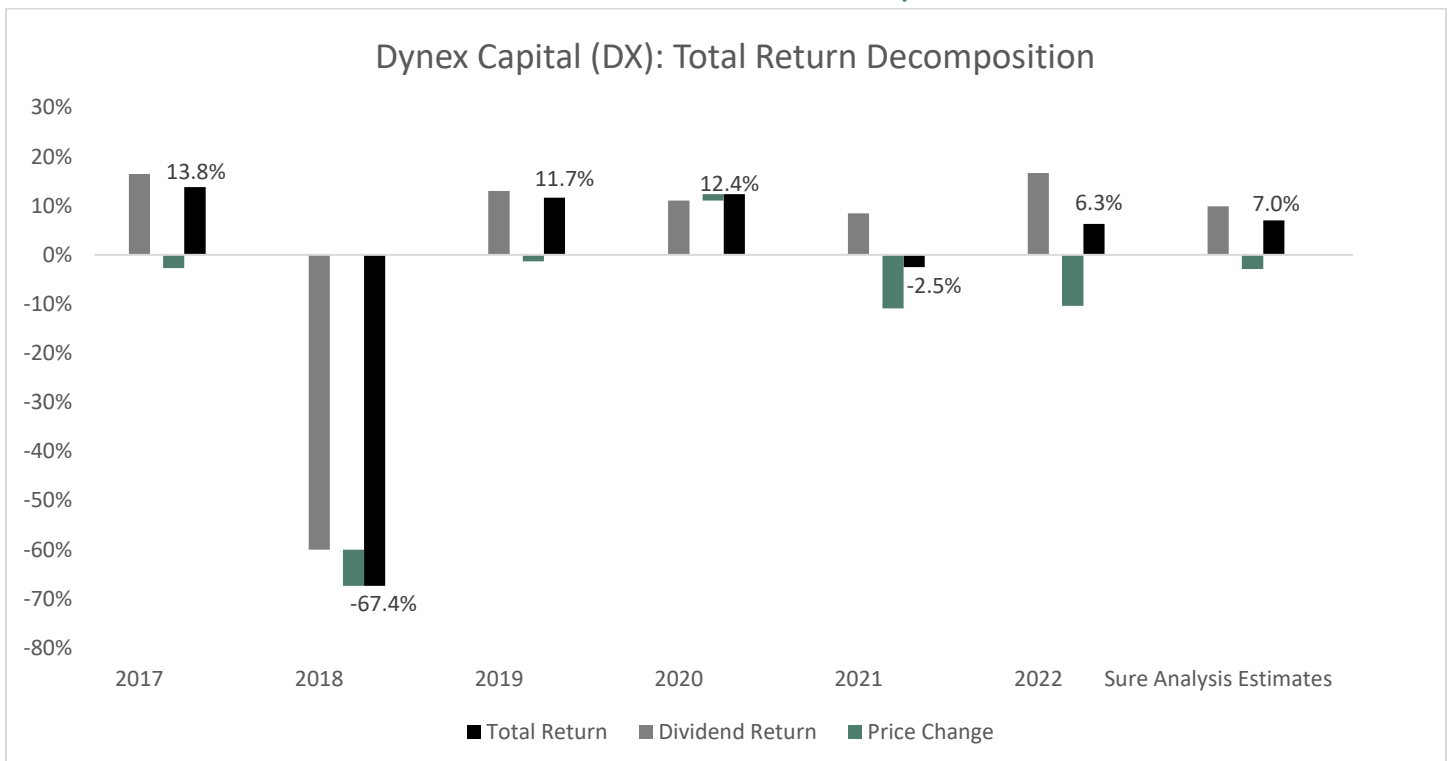
One of the biggest challenges is the shrinking spread between 3-month LIBOR and short-term repo rates, as repo rates remain elevated due to the Fed's pause on the Fed Funds rate. Another risk is that prepayment speeds could rise due to seasonal factors. Additionally, the fall in mortgage rates could 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 7%. 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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	81	43	34	57	50	24	(137)	200	128	177
SG&A Exp.	13	16	18	15	16	15	16	21	24	32
D&A Exp.	8	9	5	2	1	1	2	2	2	
Net Profit	68	28	17	43	34	7	(153)	178	102	143
Net Margin	83.6%	65.3%	49.3%	75.8%	68.0%	29.6%	112%	88.9%	80.1%	80.9%
Free Cash Flow	209	214	217	211	204	181	175	174	147	

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	4,217	3,688	3,670	3,398	3,306	3,886	5,371	3,088	3,640	3,605
Cash & Equivalents	69	44	34	74	41	35	63	296	366	332
Acc. Receivable	22	21	23	20	20	21	26	14	14	15
Total Liabilities	3,631	3,081	3,178	2,931	2,749	3,359	4,788	2,454	2,868	2,704
Accounts Payable	3	2	2	3	4	10	16	1	1	16
Long-Term Debt	13	11	528	6	6	3	3	0	-	-
Total Equity	476	498	382	357	416	384	420	459	663	793
LTD/E Ratio	0.02	0.02	1.07	0.01	0.01	0.01	0.00	0.00	-	-

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	1.6%	0.7%	0.4%	1.2%	1.0%	0.2%	-3.3%	4.2%	3.0%	4.0%
Return on Equity	13.1%	5.7%	3.8%	11.7%	8.8%	1.8%	-38.0%	40.4%	18.2%	19.7%
ROIC	10.9%	4.6%	2.0%	5.8%	6.5%	1.3%	-27.4%	29.1%	14.6%	17.1%
Shares Out.	18	18	18	16	17	19	24	23	37	53
Revenue/Share	4.47	2.33	1.90	3.47	2.97	1.23	(5.79)	8.64	3.90	4.14
FCF/Share	11.46	11.76	12.32	12.85	12.17	9.39	7.42	7.53	4.49	

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

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