



Dynex Capital Inc. (DX)

Updated February 15th, 2024 by Samuel Smith

Key Metrics

Current Price:	\$12.4	5 Year CAGR Estimate:	2.5%	Market Cap:	\$712.4M
Fair Value Price:	\$8.0	5 Year Growth Estimate:	0.0%	Ex-Dividend Date:	2/22/24
% Fair Value:	155%	5 Year Valuation Multiple Estimate:	-8.4%	Dividend Payment Date:	3/1/24
Dividend Yield:	12.6%	5 Year Price Target	\$8	Years of Dividend Growth:	0
Dividend Risk Score:	F	Retirement Suitability Score:	C	Rating:	Sell

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. (DX) disclosed its financial results for the fourth quarter and full year of 2023 on January 29, 2024. The company navigated a complex market environment, marked by volatility and uncertainty, to end the year on a strong note, particularly in the fourth quarter. Despite mixed results for the full year, Dynex Capital showcased its resilience and strategic agility, especially in managing its mortgage-backed securities portfolio. For Q4 2023, Dynex Capital reported a total economic return of \$1.45 per common share, contributing significantly to the modest full-year total economic return of \$0.14 per common share. The book value increased to \$13.31 per common share as of December 31, 2023. Comprehensive income stood at \$1.44 per common share for Q4, with a net income of \$0.39 per common share during the same period. Contrastingly, the company experienced a net loss of \$(0.25) per common share over the entire year. Dividends declared for Q4 amounted to \$0.39 per common share, culminating in \$1.56 per common share for the year. The leverage was reported at 7.8 times shareholders' equity as of the year's end, reflecting a strategic management approach to the investment portfolio. Dynex Capital's leadership underscored the company's ability to deliver solid returns amidst historic volatility. The firm maintained its focus on Agency mortgage-backed securities, capitalizing on opportunities presented by market fluctuations to achieve gains in its investment portfolio. The fourth quarter's performance was highlighted by an economic return of 11.8% and a total shareholder return of 12% for 2023. This achievement was attributed to the team's disciplined investment strategy and operational efficiency, even as the year presented challenges like interest rate volatility and economic uncertainty that impacted the broader real estate investment trust (REIT) sector.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	\$1.02	\$0.42	\$2.07	\$1.38	-\$0.24	\$2.16	\$1.92	\$1.97	\$1.04	(\$0.25)	(\$0.22)	\$1.00
DPS	\$3.00	\$2.88	\$2.52	\$2.16	\$2.16	\$2.01	\$1.66	\$1.56	\$1.56	\$1.56	\$1.56	\$1.00
Shares¹	18	18	16	17	19	24	23	37	53	57	57	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.

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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Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	7.25	12	40	9.5	15	NA	7.8	9.4	9	NA	12.4	8.0
Avg. Yld.	40.6%	57.1%	3.0%	16.5%	-60.0%	13.0%	11.1%	8.4%	16.7%	12.6%	12.6%	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 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	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	294%	686%	122%	157%	NA	93%	86%	79%	150%	NA	NA	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.

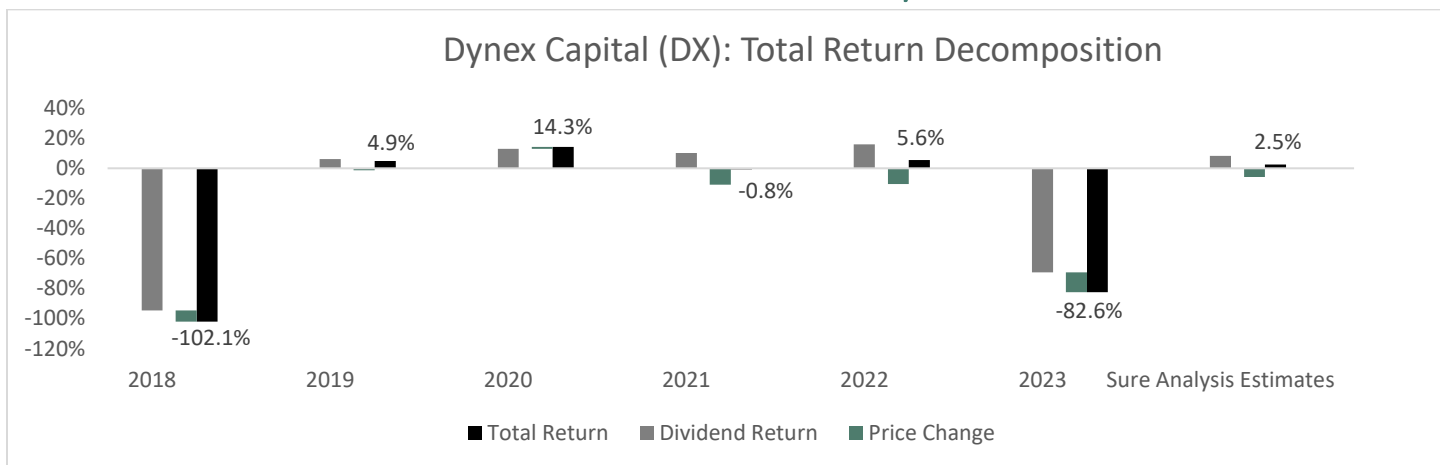
One of the biggest challenges is the shrinking spread between 3-month LIBOR and short-term repo rates, as repo rates remain elevated due to the Fed's pause on the Fed Funds rate. Another risk is that prepayment speeds could rise due to seasonal factors. Additionally, the fall in mortgage rates could 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 2.5%. 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 Sell despite its attractive dividend yield.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	43	34	57	50	24	(137)	200	128	177	27
SG&A Exp.	16	18	15	16	15	16	21	24	32	31
D&A Exp.	9	5	2	1	1	2	2	2	2	
Net Profit	28	17	43	34	7	(153)	178	102	143	(6)
Net Margin	65.3%	49.3%	75.8%	68.0%	29.6%	112%	88.9%	80.1%	80.9%	-22.9%
Free Cash Flow	214	217	211	204	181	175	174	147	126	

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	3,688	3,670	3,398	3,306	3,886	5,371	3,095	3,640	3,605	6,370
Cash & Equivalents	44	34	74	41	35	63	296	366	332	120
Acc. Receivable	21	23	20	20	21	26	14	14	15	29
Total Liabilities	3,081	3,178	2,931	2,749	3,359	4,788	2,461	2,868	2,704	5,499
Accounts Payable	2	2	3	4	10	16	1	1	16	53
Long-Term Debt	11	528	6	6	3	3	-	-	-	-
Total Equity	498	382	357	416	384	420	459	663	793	763
LTD/E Ratio	0.02	1.07	0.01	0.01	0.01	0.00	-	-	-	-

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	0.7%	0.4%	1.2%	1.0%	0.2%	-3.3%	4.2%	3.0%	4.0%	-0.1%
Return on Equity	5.7%	3.8%	11.7%	8.8%	1.8%	-38.0%	40.4%	18.2%	19.7%	-0.8%
ROIC	4.6%	2.0%	5.8%	6.5%	1.3%	-27.4%	29.1%	14.6%	17.1%	-0.7%
Shares Out.	18	18	16	17	19	24	23	37	53	57
Revenue/Share	2.33	1.90	3.47	2.97	1.23	(5.79)	8.64	3.90	4.14	0.49
FCF/Share	11.76	12.32	12.86	12.17	9.39	7.42	7.53	4.49	2.96	

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

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