



# Dynex Capital Inc. (DX)

Updated August 21<sup>st</sup>, 2024 by Samuel Smith

## Key Metrics

|                             |        |  |       |                                  |                      |
|-----------------------------|--------|--|-------|----------------------------------|----------------------|
| <b>Current Price:</b>       | \$12.3 | <b>5 Year CAGR Estimate:</b>               | 2.7%  | <b>Market Cap:</b>               | \$924 M              |
| <b>Fair Value Price:</b>    | \$8.0  | <b>5 Year Growth Estimate:</b>             | 0.0%  | <b>Ex-Dividend Date:</b>         | 9/22/24 <sup>1</sup> |
| <b>% Fair Value:</b>        | 154%   | <b>5 Year Valuation Multiple Estimate:</b> | -8.2% | <b>Dividend Payment Date:</b>    | 10/3/24 <sup>2</sup> |
| <b>Dividend Yield:</b>      | 12.7%  | <b>5 Year Price Target</b>                 | \$8   | <b>Years of Dividend Growth:</b> | 0                    |
| <b>Dividend Risk Score:</b> | F      | <b>Retirement Suitability Score:</b>       | C     | <b>Rating:</b>                   | 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) announced its second-quarter 2024 financial results on July 22, 2024. The company reported a total economic loss of \$(0.31) per common share, which represents a decrease of 2.4% of the beginning book value. The book value per common share was \$12.50 as of June 30, 2024. The comprehensive loss was \$(0.18) per common share, and the net loss was \$(0.15) per common share. Despite these losses, Dynex declared dividends of \$0.39 per common share for the second quarter. During the quarter, Dynex raised \$124.7 million in equity capital through a public offering of common stock and at-the-market (ATM) issuances. The company also purchased \$551.1 million of higher coupon Agency RMBS, bolstering its portfolio. As of June 30, 2024, Dynex had \$644.0 million in liquidity and a leverage ratio, including to-be-announced (TBA) securities at cost, of 7.9 times shareholders' equity. Commenting on the results, Byron L. Boston, Chairman and Co-Chief Executive Officer, highlighted the company's strategic focus on delivering consistent dividend income and disciplined capital management. He emphasized that Dynex is well-positioned to take advantage of the current mortgage market's wide spreads and noted the importance of human capital in building for future success.

## Growth on a Per-Share Basis

| Year                      | 2014   | 2015   | 2016   | 2017   | 2018    | 2019   | 2020   | 2021   | 2022   | 2023     | 2024            | 2029          |
|---------------------------|--------|--------|--------|--------|---------|--------|--------|--------|--------|----------|-----------------|---------------|
| <b>EPS</b>                | \$1.02 | \$0.42 | \$2.07 | \$1.38 | -\$0.24 | \$2.16 | \$1.92 | \$1.97 | \$1.04 | (\$0.25) | <b>(\$0.22)</b> | <b>\$1.00</b> |
| <b>DPS</b>                | \$3.00 | \$2.88 | \$2.52 | \$2.16 | \$2.16  | \$2.01 | \$1.66 | \$1.56 | \$1.56 | \$1.56   | <b>\$1.56</b>   | <b>\$1.00</b> |
| <b>Shares<sup>3</sup></b> | 18     | 18     | 16     | 17     | 19      | 24     | 23     | 37     | 54     | 59       | <b>75</b>       | <b>42</b>     |

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             | 2014  | 2015  | 2016 | 2017  | 2018 | 2019  | 2020  | 2021 | 2022  | 2023  | Now          | 2029         |
|------------------|-------|-------|------|-------|------|-------|-------|------|-------|-------|--------------|--------------|
| <b>Avg. P/E</b>  | 7.25  | 12    | 40   | 9.5   | 15   | NA    | 7.8   | 9.4  | 9     | NA    | <b>12.3</b>  | <b>8.0</b>   |
| <b>Avg. Yld.</b> | 40.6% | 57.1% | 3.0% | 16.5% | NA   | 13.0% | 11.1% | 8.4% | 16.7% | 12.6% | <b>12.7%</b> | <b>12.5%</b> |

<sup>1</sup> Estimated

<sup>2</sup> Estimated

<sup>3</sup> Share count in millions

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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.

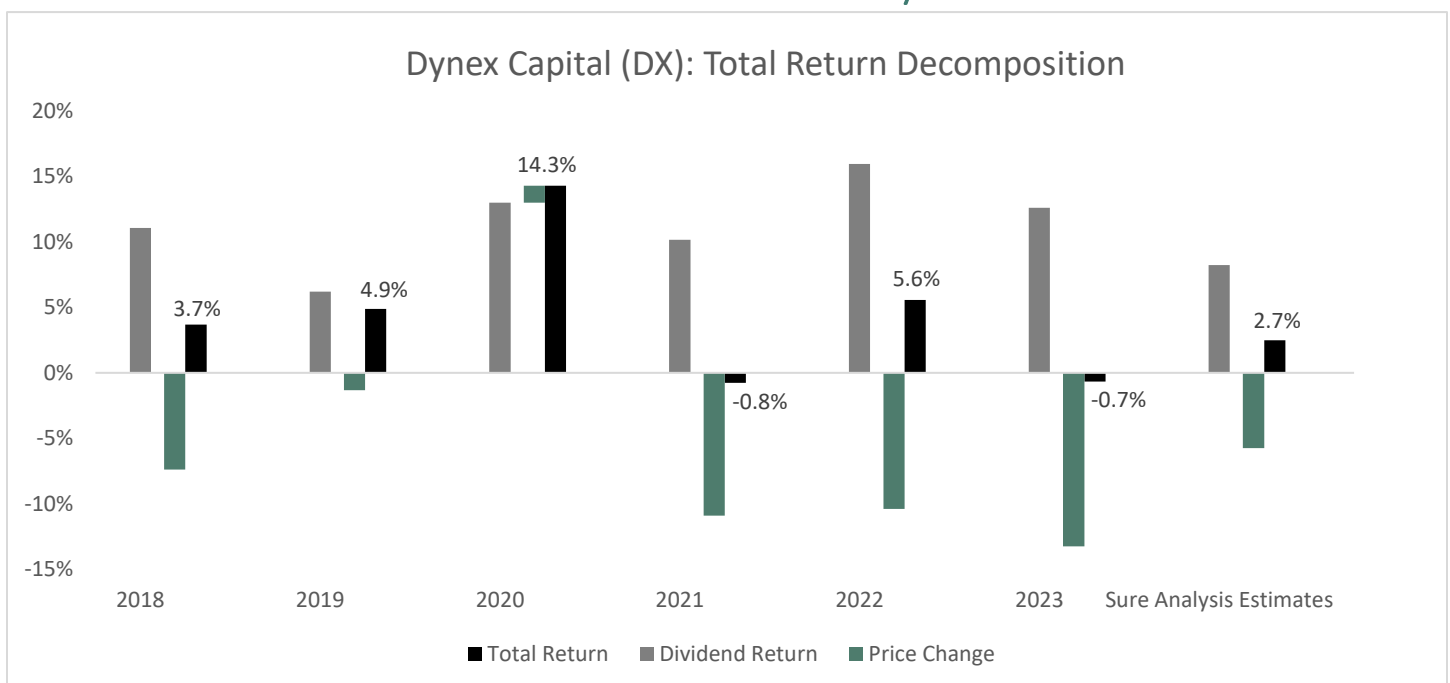
One of the biggest challenges is the shrinking spread between 3-month LIBOR and short-term repo rates, as repo rates remain elevated due to the Fed's pause on the Fed Funds rate. Another risk is that prepayment speeds could rise due to seasonal factors. Additionally, the fall in mortgage rates could 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 2.7%. 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 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   |
|-----------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|--------|
| <b>Revenue</b>        | 43    | 34    | 57    | 50    | 24    | (137) | 200   | 128   | 177   | 27     |
| <b>SG&amp;A Exp.</b>  | 16    | 18    | 15    | 16    | 15    | 16    | 21    | 24    | 32    | 31     |
| <b>D&amp;A Exp.</b>   | 9     | 5     | 2     | 1     | 1     | 2     | 2     | 2     | 2     |        |
| <b>Net Profit</b>     | 28    | 17    | 43    | 34    | 7     | (153) | 178   | 102   | 143   | (6)    |
| <b>Net Margin</b>     | 65.3% | 49.3% | 75.8% | 68.0% | 29.6% | 112%  | 88.9% | 80.1% | 80.9% | -22.9% |
| <b>Free Cash Flow</b> | 214   | 217   | 211   | 204   | 181   | 175   | 174   | 147   | 126   |        |

## Balance Sheet Metrics

| Year                          | 2014  | 2015  | 2016  | 2017  | 2018  | 2019  | 2020  | 2021  | 2022  | 2023  |
|-------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| <b>Total Assets</b>           | 3,688 | 3,670 | 3,398 | 3,306 | 3,886 | 5,371 | 3,095 | 3,640 | 3,605 | 6,370 |
| <b>Cash &amp; Equivalents</b> | 44    | 34    | 74    | 41    | 35    | 63    | 296   | 366   | 332   | 120   |
| <b>Acc. Receivable</b>        | 21    | 23    | 20    | 20    | 21    | 26    | 14    | 14    | 15    | 29    |
| <b>Total Liabilities</b>      | 3,081 | 3,178 | 2,931 | 2,749 | 3,359 | 4,788 | 2,461 | 2,868 | 2,704 | 5,499 |
| <b>Accounts Payable</b>       | 2     | 2     | 3     | 4     | 10    | 16    | 1     | 1     | 16    | 53    |
| <b>Long-Term Debt</b>         | 11    | 528   | 6     | 6     | 3     | 3     | -     | -     | -     | -     |
| <b>Total Equity</b>           | 498   | 382   | 357   | 416   | 384   | 420   | 459   | 663   | 793   | 763   |
| <b>LTD/E Ratio</b>            | 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  |
|-------------------------|-------|-------|-------|-------|------|--------|-------|-------|-------|-------|
| <b>Return on Assets</b> | 0.7%  | 0.4%  | 1.2%  | 1.0%  | 0.2% | -3.3%  | 4.2%  | 3.0%  | 4.0%  | -0.1% |
| <b>Return on Equity</b> | 5.7%  | 3.8%  | 11.7% | 8.8%  | 1.8% | -38.0% | 40.4% | 18.2% | 19.7% | -0.8% |
| <b>ROIC</b>             | 4.6%  | 2.0%  | 5.8%  | 6.5%  | 1.3% | -27.4% | 29.1% | 14.6% | 17.1% | -0.7% |
| <b>Shares Out.</b>      | 18    | 18    | 16    | 17    | 19   | 24     | 23    | 37    | 53    | 57    |
| <b>Revenue/Share</b>    | 2.33  | 1.90  | 3.47  | 2.97  | 1.23 | (5.79) | 8.64  | 3.90  | 4.14  | 0.49  |
| <b>FCF/Share</b>        | 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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