

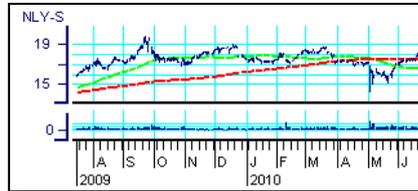
## REIT Growth and Income Monitor

**BUY**

Annaly Capital Management NLY \$18

06/22/2010

Ranking: 2



Closing stock price and volume are shown in blue lines on top and bottom of chart. 200 day moving average stock price is shown in red and 50 day moving average stock price is shown in green.

### Comments:

**EPS for the first quarter of 2010 increased 11% from the previous year, supported by \$47 million gains on portfolio sales, offset by (\$116) million unrealized losses on interest rate swaps.**

**Unusual purchases and prepayments by Fannie Mae during the first and second quarter of 2010 temporarily compresses average portfolio yield.**

**Pending exit of Fannie Mae and Freddie Mac as bidders from the MBS market in June 2010 creates a new challenge for the post crisis mortgage market.**

**Dividends increased 5% to \$0.68 per share for the third quarter of 2010, providing income investors with yield of more than 15%.**

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REIT Growth and Income Monitor is a product of Atlantis Investment Co., Inc., founded in 1986. Research involves analysis of fundamental issues and discussion of critical variables that will determine stock price performance. Particular attention is paid to potential negative trends in business or to conflicts of interest in a company's insider ownership. BUY, SELL, and HOLD recommendations are provided with a ranking system of 1 to 5. Assignment of a 1 rank indicates expected total return of 50% within 18 months, a 2 indicates expected total return of more than 25%, a 3 indicates stock price performance in line with the market, a 4 indicates an expected stock price decline of more than 15%, and a 5 indicates expected stock price decline of more than 25%.

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# REIT Growth and Income Monitor

Annaly Capital Management (NLY)

06/22/2010

BUY

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Quarterly Dividend  
 Ex Date 06/25/10  
 Record Date 06/29/10  
 Pay Date 07/29/10

Price	\$18
Dividend	\$2.72
Yield	15.26%

Annualized FFO	\$2.48
FFO % of Dividend	91%
Total Cap/FFO	51.1X

# Shares Out	575.9
Market Cap	\$10,262
Market Cap/ Annualized Rev	7.8X

Revenue Growth Rate	-23%
Annualized Revenue	\$1,314
Sector	Financial/Mortgage REIT

## Description of Assets

- Annaly Capital Management owns and manages a portfolio consisting of single-family residential mortgage loans in the form of MBS (mortgage backed securities). Income is generated from the spread between interest income and the cost of borrowing for investment in FNMA, GNMA, or FHLMC passthrough securities, carrying an implied AAA rating. Annaly owns a taxable REIT subsidiary, FIDAC.
- Annaly classifies its entire \$67.2 billion portfolio as "available for sale," valued at current market value as opposed to historical cost. Fixed rate mortgage-backed securities represent 77% of the portfolio, adjustable rate mortgage-backed securities 20%, and LIBOR floating rate collateralized mortgage obligations 3%. For the first quarter of 2009, 200% of Annaly's revenue was attributed to net interest income, with 4% contribution from investment advisory and service fees, partially offset (104%) by unrealized losses on interest rate swaps, dividend income and net gains on sale of MBS securities.

## Productivity of Assets

Total Assets	\$72,719,162
Total Space	NA
Revenue/Assets	3%
Revenue/unit	NA
Occupancy Rate	NA
% of leases Expiring in 4yrs	NA

## Capital Structure

Notes/Lines of Credit	\$61,283,912
Mortgages	\$0
Senior Debt	\$500,000
Preferred Stock	\$240,186
Minority Interest	0
Total Equity	\$9,581,386

Average Cost of Debt	2.00%
Book Value	\$16.64

Interest Coverage	2.2X
EBITDA	\$2,856,830

## Key Issues

- Annaly Capital Management operates as a self-managed REIT, with FIDAC as Annaly's wholly-owned taxable REIT subsidiary, since merger of Annaly Capital Management with Fixed Income Discount Advisory Company (FIDAC) in June, 2004. FIDAC is a registered investment advisor, generating net investment advisory fees of 0.1%-0.2% of assets under management. FIDAC has \$11.6 billion in net assets and \$20.3 billion in gross assets under management, as of March, 2010. FIDAC earned \$12.2 million in investment advisory and service fees for the first quarter of 2010, up 67% from the previous year.
- FIDAC externally manages 2 publicly traded specialty finance companies, Chimera Investment Corporation and CreXus. Both Chimera [Ticker: CIM] and CreXus [Ticker: CXS] operate as publicly traded REITs. Annaly Capital Management owns 25% of CreXus, a specialty finance company established to acquire new issues of commercial loans. Annaly Capital Management formed a new subsidiary, Ranger Capital Corp., in October, 2008, to operate as a broker/dealer selling investment products. Ranger Capital has since been renamed as RCap, operating as a member of FINRA since January, 2009. Annaly Capital Management acquired Merganser Capital Management, a Boston based institutional fixed income manager with \$4.6 billion in assets under management, during the fourth quarter of 2008.
- Annaly Capital Management earns income through net interest spread on a portfolio of MBS issued by Fannie Mae, Freddie Mac and Ginnie Mae. Credit quality for Annaly Capital Management's portfolio of agency MBS was improved by government takeover of Fannie Mae and Freddie Mac during July, 2008. Federal Reserve moves to lower interest rates support increasing net interest margin through lower cost of funds for short term financing of MBS portfolios.
- Pending exit of Fannie Mae and Freddie Mac as bidders from the MBS market by June, 2010 creates a new challenge for the post crisis mortgage market. Uncertainty over liquidity and buying interest for new MBS issues may impact pricing of securities held in Annaly Capital Management's investment portfolio of MBS securities during the re-adjustment period. Unusual purchases and prepayments of low credit quality MBS by Fannie Mae during the first and second quarter of 2010 temporarily compressed Annaly Capital Management's average portfolio yield on remaining securities.
- Total MBS portfolio of \$67.2 billion for the first quarter of 2010 included 77% fixed rate securities, 20% ARMs, and 3% LIBOR floating rate collateralized mortgage obligations. After taking swaps into effect, Annaly's portfolio is 37% floating rate, 20% ARMs and 43% fixed rate assets. Since much of the portfolio is locked into fixed rate agreements, the portfolio is positioned to perform well in the event that the Federal Reserve does not increase interest rates and will outperform when the Federal Reserve lowers interest rates. In the event that the Federal Reserve increases interest rates, Annaly would face yield compression and experience portfolio impairments.
- Average portfolio yield was 4.22% for the first quarter of 2010, with average cost of funds of 2.00%, resulting in NIM (net interest margin) of 2.22%, down (0.57%) from the previous quarter's NIM. Annaly's constant prepayment rate (CPR) increased sharply to 34% (up from 19% for the fourth quarter of 2009), reflecting unusual Fannie Mae repurchases of lower credit quality MBS. Leverage on MBS portfolio decreased from the previous quarter's 5.7X to 5.5X for the first quarter of 2010.
- Net interest income for the first quarter of 2009 increased 12% from the previous year, but decreased (17%) from the fourth quarter of 2009 due to lower yield and unusual portfolio purchases and prepayments by Fannie Mae. During the first quarter of 2010, Annaly recorded unrealized losses of (\$116) million from interest rate swaps, partially offset by \$47 million gains on portfolio sales. Total operating expenses increased 8% from the previous quarter to \$40 million.
- Offerings added liquidity for portfolio investments. Annaly sold \$100 million senior convertible notes yielding 4% in March, 2010, with Credit Suisse Securities acting as sole bookrunning manager. Annaly Capital raised \$1.1 billion from a public offering of 69 million shares in May, 2008, with Morgan Stanley and Merrill Lynch as joint bookrunning managers, senior co-managers Credit Suisse and Deutsche Bank, and co-managers Citi, UBS and JPMorgan. Annaly sold 59 million shares for \$1.1 billion in January, 2008.
- Annaly Capital Management named Eric Szabo, Managing Director and Chief Risk Officer, Matthew J. Lambiase and Kevin Riorden as Managing Directors in June, 2009. Mr Szabo joined Annaly Capital Management and FIDAC in 2004 and has served as an Investment Strategist for Annaly Capital Management. Mr. Lambiase joined Annaly Capital Management and FIDAC in 2004 and serves as CEO and President of Chimera Investment Corporation. Mr. Riorden, CEO and President of CreXus, joined Annaly Capital Management and FIDAC in 2008 with more than 25 years of experience in CMBS securities.
- "Core EPS" for the first quarter of 2010 was \$0.62 per share, up 11% from restated "Core EPS" of \$0.56 per share for the previous year. EPS for the first quarter of 2010 was supported by \$47 million gains on portfolio sales of \$1.6 billion, offset by (\$166) million unrealized losses on interest rate swaps. For 2009, GAAP EPS of \$3.52 per share increased more than 5-fold from the previous year's EPS of \$0.64 per share.
- No guidance for EPS for 2010 has been announced. Results to be reported for 2010 may include additional provisions for loan losses and portfolio impairments.
- Quarterly dividend distributions increased 5% to \$0.68 per share for the third quarter of 2010, a new annual rate of \$2.72 per share. Dividend distributions for 2009 of \$2.20 per share (up from \$1.92 per share for 2008) were taxed 100% as ordinary income.

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Annaly Capital Management (NLY)

06/22/2010

BUY

**Table 1: Capitalization by Sector (Financial/Mortgage REIT)**

Company Name	Ticker	Yield	Market Capitalization	Total Capitalization	Debt and Non-Trading % of Total	Total Capitalization/ FFO Ratio
Annaly Capital Management	NLY	15.26%	\$10,262	\$72,994	86%	51.1X
Anworth Mortgage Asset	ANH	15.21%	\$854	\$6,355	87%	48.9X
Capstead Mortgage Corporation	CMO	12.65%	\$904	\$8,259	89%	51.0X
Cypress Sharpridge Investments	CYS	16.85%	\$267	\$360	26%	8.6X
Hatteras Financial	HTS	16.16%	\$1,076	\$7,323	85%	41.7X
MFA Financial	MFA	12.63%	\$2,129	\$8,344	74%	25.7X
Redwood Trust	RWT	6.33%	\$1,241	\$5,231	76%	NM

NOTE: Total capitalization includes market capitalization plus non-trading components of capitalization, including debt, preferred stock, and minority interest. Total capitalization represents the total valuation an acquiror would have to pay to acquire the company. The ratio of total capitalization to FFO indicates the total current valuation relative to FFO (funds flow from operations), a consistent number reported by REITs according to the NAREIT definition.

### Valuation Comments

Annaly Capital Management's yield of 15.26% is at the high end of the range for the Financial/Mortgage REIT sector. Total capitalization relative to FFO of 51.1X is the highest of the range, as shown in Table 1, above. (Total capitalization represents the total valuation that would be paid for the company in an acquisition at today's price.) Debt as percentage of total capitalization for Annaly Capital Management is at the high end of the range, at 86%, as compared to a range of 26%-89% for all of the companies shown in the Financial/Mortgage REIT sector.

### REIT Rank and Target Price

REIT Growth and Income Monitor analysts assign ranks to each REIT on the basis of dividend yield, dividend growth, and expected stock price performance over a period of 18 months. BUY, SELL and HOLD recommendations are provided with a ranking system of 1 to 5. Assignment of a 1 BUY rank indicates expected total return of 50% within 18 months, a 2 BUY rank indicates expected total return of more than 25%, a 3 HOLD rank indicates stock price performance in line with the market, a 4 SELL rank indicates an expected stock price decline of more than 15% and a 5 SELL rank indicates expected stock price decline of more than 25%.

Our assignment of a rank of 2 BUY for Annaly Capital Management assesses the REIT's ability to maintain and increase dividend growth, as supported by FFO trends. Using the inputs of Annaly Capital Management's current dividend yield of 15.26%, guidance for FFO growth for the current year, and Annaly Capital Management's historical achievement of FFO growth, we estimate dividend growth in a range of 15%-20% and stock price appreciation in a range of 20%-30%. On this basis, our model suggests a target price for Annaly Capital Management of \$26 per share, implying the potential for stock price appreciation of 44%.

**Table 2: Fundamental Comparisons**

Company Name	Ticker	Yield	Total Assets	Revenue / Assets	Interest Coverage	Total Space	Occupancy Rate
Annaly Capital Management	NLY	15.26%	\$72,719,162	3%	2.2X	NA	NA
Anworth Mortgage Asset	ANH	15.21%	\$6,567,901	2%	2.1X	NA	NA
Capstead Mortgage Corporation	CMO	12.65%	\$8,234,660	2%	2.3X	NA	NA
Cypress Sharpridge Investments	CYS	16.85%	\$1,840,897	6%	0.4X	NA	NA
Hatteras Financial	HTS	16.16%	\$7,224,131	3%	2.8X	NA	NA
MFA Financial	MFA	12.63%	\$8,434,713	3%	2.1X	NA	NA
Redwood Trust	RWT	6.33%	\$5,195,000	2%	2.0X	NA	NA

### Description of FFO

REIT Growth and Income Monitor uses FFO (funds flow from operations) as a means of comparison among REITs in different sectors, because FFO has been defined by the National Association of Real Estate Investment Trusts (NAREIT). FFO is a number reported by almost all REITs according to a consistent definition. NAREIT defines FFO as follows: income available for common shareholders before depreciation and amortization of real estate assets, and before extraordinary items and significant nonrecurring events less gains on sale of real estate. Funds flow from operations does not replace net income as a measure of performance of net cash provided by operating activities as a measure of liquidity. Rather, funds from operations have been adopted by REITs to provide a consistent measure of operating performance in the industry. REIT Growth and Income Monitor adjusts FFO to exclude non-cash impairment charges, litigation settlements, and charges for debt redemption. The result is a number that represents the recurring funds flow from operations available to support operations and to pay dividends to shareholders. The ratio of FFO to the dividend may represent an indication of the REIT's ability to maintain and to increase dividend distributions. The ratio of total capitalization to annualized FFO indicates a consistent valuation measurement that may be used to compare the current valuation of a REIT to other REITs within the same sector.

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