CANTOR Fitzgerald

Company Update
October 17, 2011
MORTGAGE REITS

Equity Research

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Annaly Capital Management, Inc. (NLY-$16.12)

Rating: BUY

Target Price: $16.75

Lowering Target Price to $16.75 Due to Increased Risks

EPS	1Q	2Q	3Q	4Q
2010A	0.48A	(0.40)A	(0.03)A	1.83A
2011E	0.88A	0.14A	0.60E	0.55E
Prev	—	—	*0.65E*	*0.65E*
2012E	0.48E	0.48E	0.48E	0.48E

FY	2010A	2011E	2012E
EPS	2.04A	2.17E	1.92E
Prev	—	*2.33E*	—
P/E	7.9x	7.4x	8.4x

- We are lowering our target price for Annaly to $16.75 (from $18.00), due to increased risks.
- These risks include: (1) a refinancing wave driven by low mortgage rates, (2) a refinancing wave induced by a new U.S. Government program, (3) drying up of repo lines, and (4) loss of the SEC exemption from the Investment Company Act of 1940.
- We regard the biggest risk as a refinancing wave driven by low mortgage rates (aided by the Fed's Operation Twist). In our view, the Agency mREITs most exposed to such a refi wave are those with a high proportion of recent-vintage mortgages (all with credit-worthy borrowers). For fixed-rate-heavy Agency mREITs, that would be Annaly.
- However, our most-likely scenario would be increased CPRs, but not a refi wave (mainly due to mortgage rates not going down as much as interest rates, and to "burnout").
- Until some of these risks (see *Agency Mortgage REITs: Lowering Target Prices Due to Increased Risks*, October 17, 2011) are resolved, we do not believe that Agency mREITs as a group will trade above book value. However, we do not believe that Agency mREITs should trade below book value, because of (a) their high dividend yields (even on a risk-adjusted basis) relative to fixed-income and other dividend-yielding investments and (b) the low probability of most of these risks.
- Our new $16.75 target price is approximately Annaly's 6/30/11 book value. Our 2012 dividend estimate of $1.92 equates to an 11.9% dividend yield. Share price appreciation plus dividends should produce a 12-month total return of 16%, which is the basis for our BUY rating. See "Valuation" below.

Current Statistics

Market Cap ($B)	**15.6B**	**Insider Holdings:**	**1.0%**
Dividend Yield:	**14.90%**	**Institutional Holdings:**	**41.0%**
Shares Out (Mil):	**969.071**	**Short Interest (Mil):**	**38.700**
Tangible Book Per Share:	**$16.48**	**Avg. Daily Trading Volume (3 mo.):**	**27,693,602**

Company Description

Annaly Capital Management , Inc., which began operations in 1997, is an internally-managed mortgage REIT that invests exclusively in Agency residential mortgage-backed securities. Annaly also has subsidiaries that manage other mortgage REITs and that manage institutional fixed-income assets. Annaly has pro forma common equity of $16.4 billion, making it (by far) the largest mortgage REIT.

The Disclosure Section may be found on pages 5 - 7 of this report.

Major Differences from Peers

With a market cap of more than $15 billion, Annaly has more than 3x the market cap of the next biggest Agency mortgage REIT and 1.5x the combined market cap of all of the other Agency mortgage REITs. Indeed, Annaly's market cap is nearly equal to the combined market cap of all of the other mortgage REITs (Agency and non-Agency), excluding Chimera Investment Corporation (NYSE: CIM, HOLD) (which is the largest non-Agency mortgage REIT, and managed by Annaly). For institutional investors seeking a large dollar position and/or liquidity, Annaly is the name of choice, in our view.

No Agency mortgage REIT other than Annaly has any true diversification of revenues. All except Annaly generate all of their revenue from their Agency RMBS portfolios and related hedges. Annaly, on the other hand, is already a horizontally-integrated fixed-income asset manager, with (a) subsidiary Fixed Income Discount Advisory Company being the external manager for the largest non-Agency mortgage REIT, Chimera Investment Corporation, and for commercial mortgage REIT CreXus Investment Corp (NYSE: CXS, NC), and (b) subsidiary Merganser Capital Management being a traditional institutional fixed-income asset manager. In our view, Annaly is also in the process of becoming a vertically-integrated mortgage origination/ securitization entity for conforming and non-conforming mortgages.

More than any other Agency mortgage REIT, Annaly prefers RMBS with fixed-rate mortgage collateral (mostly 30-year). This is not a voluntary preference, in our view, but a recognition that there is not enough liquidity in RMBS with floating-rate collateral for an entity of Annaly's size (pro forma about $110 billion RMBS portfolio) to be able to get in and out of positions quickly and efficiently. Indeed, RMBS with floating-rate collateral comprise less than 10% of all Agency RMBS and thus are much less liquid. In our view, this preference for fixed-income mortgage collateral also constitutes a major shift in strategy for Annaly, away from Annaly's so-called barbell strategy, where RMBS with floating-rate collateral were preferred in times of rising interest rates. This heavy weighting in 30-year fixed-rate collateral could be an issue for Annaly (a) when interest rates increase (due to the relative difficulty of hedging RMBS with 30-year fixed-rate collateral) and (b) when interest rates decrease (due to prepayment risk, especially given that as much as one-half of Annaly's RMBS portfolio has recent-vintage collateral, with credit-worthy borrowers).

Current Environment, and Risk from Low Mortgage Rates

The current environment remains favorable for Agency mortgage REITs, in our view, due to (a) a relatively steep yield curve, (b) low interest rates, (c) readily available financing, (d) inexpensive hedging, and (e) relatively slow prepayment speeds. This environment is enabling the seven Agency mortgage REITs that we follow to pay an average annualized dividend yield of 16.9% currently. But this environment will not last forever. Investors should also take into account the risk of increased prepayments (due to low mortgage rates).

Valuation

We regard the best comparables for Annaly as the other Agency mortgage REITs. Though no two are exactly alike, they all share common business model attributes related to (a) composition of RMBS portfolio (exclusively Agency RMBS), (b) duration of investment portfolio (including ARMs versus hybrid ARMs versus 15-year fixed-rate versus 30-year fixed-rate), (c) leverage, and (d) hedging. Currently, all trade within a relatively narrow band relative to book value (average 1.0x).

Annaly is currently benefiting from a favorable environment for Agency mortgage REITs, which we expect to persist through 2012. This environment should enable Annaly to sustain an ROE similar to peers through 2012. Accordingly, we believe that Annaly should trade in line with peers on a book value basis. Our $16.75 target price assumes a peer book value multiple of 1.0x. Our 2012 dividend estimate of $1.92 equates to an 11.9% dividend yield. Share price appreciation plus dividends should produce a 12-month return of 16%. Accordingly, we rate Annaly a BUY.

We note that we rate mortgage REITs on the basis of total return, that is, dividend yield plus stock price appreciation, with a 15% total return being the minimum for a BUY rating.

Risks

We regard the main risks as interest rate risk, prepayment risk, liquidity risk, and government/regulatory risk. We note that Annaly hedges to some degree against interest rate risk and prepayment risk. See also Annaly's most recent 10-Q or 10-K for additional risks.

Interest Rate Risk: If interest rates increase, it is possible that (a) the spread could narrow between yields on Annaly's RMBS and the cost of Annaly's repurchase agreements, thereby lowering net interest income, and/or (b) the net change in fair value of Annaly's assets and liabilities could be negative. If so, then Annaly would be less likely to achieve our EPS estimates, and Annaly's book value could decline, thereby making it less likely that NLY shares achieve our target price.

Prepayment Risk: If interest rates (and mortgage rates) decrease, it is possible that Annaly's RMBS could prepay faster than the speeds reflected in the prices that Annaly paid for those securities, thereby (a) accelerating the amortization of the premium paid for those securities and (b) lowering the yield at which the proceeds of the prepayments could be re-invested. If so, then Annaly would be less likely to achieve our EPS estimates, thereby making it less likely that NLY shares achieve our target price.

Liquidity Risk: Annaly's main source of borrowed funds is repurchase agreements. If repurchase agreements were unavailable, or available on much less favorable terms (higher borrowing rates, lower advance rates), then Annaly might have to deleverage, in which case Annaly would be less likely to achieve our EPS estimates, thereby making it less likely that NLY shares achieve our target price.

Government/Regulatory Risk: If (a) the U.S. Government institutes a mass-refinance program and/or (b) the SEC removes or modifies materially the mortgage REIT exemption from the Investment Company Act of 1940, then Annaly would be less likely to achieve our EPS estimates, thereby making it less likely that NLY shares achieve our target price.

Annaly Capital Management, Inc.
Quarterly Income Statement

(Dollars in millions, except per-share data)

Annaly Capital Management, Inc.	2010A				2011E				2012E						
Fiscal Year Ends December	**1QA**	**2QA**	**3QA**	**4QA**	**1QA**	**2QA**	**3QE**	**4QE**	**1QE**	**2QE**	**3QE**	**4QE**	**2010A**	**2011E**	**2012E**
Earning Assets	70,172	71,813	78,221	79,570	94,080	97,505	112,505	112,505	112,505	112,505	112,505	112,505	74,944	104,148	112,505
Debt / Equity	5.8	6.1	6.6	6.8	6.4	5.8	5.8	5.8	5.8	5.8	5.8	5.8	6.3	5.9	5.8
Net Asset Yield	4.22%	4.16%	4.06%	3.65%	3.79%	4.04%	-	-	-	-	-	-	0.029	0.020	-
Cost of Funds	2.00%	2.00%	1.95%	1.80%	1.62%	1.59%	-	-	-	-	-	-	0.013	0.008	-
Spread (basis points)	2.22%	2.16%	2.11%	1.85%	2.17%	2.45%	-	-	-	-	-	-	0.016	0.012	-
Net Interest Margin	2.44%	2.35%	2.31%	2.02%	2.40%	2.60%	2.41%	2.20%	1.94%	1.94%	1.94%	1.94%	2.28%	2.40%	1.94%
Interest Income	654.389	643.682	702.976	682.087	844.048	957.068							2,683.134	1,801.116	-
Interest expense	276.509	280.242	302.568	304.013	321.604	113.320							1,163.332	434.924	-
Net Interest Income	**377.880**	**363.440**	**400.408**	**378.074**	**522.444**	**843.748**	**662.750**	**618.775**	**545.647**	**545.647**	**545.647**	**545.647**	**1,519.802**	**2,647.717**	**2,182.588**
														-	-
Investment Advisory and Service Fees	12.546	13.863	15.343	16.321	17.207	20.710	21.124	21.547	21.978	22.417	22.866	23.323	58.073	80.588	90.583
Realized Gain on Sale of MBS/Agency Debentures	46.962	39.041	61.986	33.802	27.185	7.336	-	-	-	-	-	-	181.791	34.521	-
Dividend Income	7.964	7.330	8.097	7.647	6.297	8.230	8.230	8.230	8.230	8.230	8.230	8.230	31.038	30.987	32.920
Unrealized Gain on Interest Rate Swaps / IOs	(116.732)	(593.038)	(448.253)	839.191	169.308	(466.667)	-	-	-	-	-	-	(318.832)	(297.359)	-
Gain on Trading Securities	-	0.077	1.082	(3.510)	18.812	(5.712)	-	-	-	-	-	-	16.461	13.100	-
Income from Underwriting	-	0.500	0.915	0.680	2.904	(0.077)	-	-	-	-	-	-	2.095	2.827	-
Realized Gains on Interest Rate Swaps			-	-	-	(216.760)									
Net Investment Income (GAAP)	**328.620**	**(168.787)**	**39.578**	**1,272.205**	**764.157**	**190.808**	**692.104**	**648.552**	**575.855**	**576.294**	**576.742**	**577.200**	**1,471.616**	**2,295.621**	**2,306.091**
Net Investment Income (Core)	**398.390**	**385.133**	**424.763**	**402.722**	**548.852**	**655.851**	**692.104**	**648.552**	**575.855**	**576.294**	**576.742**	**577.200**	**1,611.008**	**2,545.359**	**2,306.091**
Distribution Fees	0.360	-	-	-	-	-	-	-	-	-	-	-	0.360	-	-
General and Administrative Expenses	40.021	41.540	43.430	46.496	51.827	57.229	57.229	57.229	57.229	57.229	57.229	57.229	171.487	223.514	228.916
Total Non-Interest Expenses	**40.381**	**41.540**	**43.430**	**46.496**	**51.827**	**57.229**	**57.229**	**57.229**	**57.229**	**57.229**	**57.229**	**57.229**	**171.847**	**223.514**	**228.916**
Income from Equity Method Investment	0.140	0.935	0.868	1.002	1.140	-	-	-	-	-	-	-	2.945	1.140	-
Income Before Income Taxes	288.379	(209.392)	(2.984)	1,226.711	713.470	133.579	634.875	591.323	518.626	519.065	519.513	519.971	1,302.714	2,073.247	2,077.175
Income Taxes	7.314	8.837	11.076	8.207	13.575	12.762	60.655	56.494	49.549	49.591	49.634	49.677	35.434	143.487	198.451
Tax Rate	2.5%	-4.2%	-371.2%	0.7%	1.9%	9.6%	9.6%	9.6%	9.6%	9.6%	9.6%	9.6%	2.7%	6.9%	9.6%
Net Income (GAAP)	281.065	(218.229)	(14.060)	1,218.504	699.895	120.817	574.220	534.828	469.077	469.474	469.880	470.293	**1,267.280**	**1,929.760**	**1,878.724**
Net Income (Core)	**350.835**	**335.691**	**371.125**	**349.021**	**484.590**	**585.860**	**574.220**	**534.828**	**469.077**	**469.474**	**469.880**	**470.293**	**1,406.672**	**2,179.498**	**1,878.724**
Preferred Dividends	4.625	4.625	4.515	4.268	4.267	4.267	4.267	4.267	4.267	4.267	4.267	4.267	18.033	17.068	17.068
Net Income to Common (GAAP)	**276.440**	**(222.854)**	**(18.575)**	**1,214.236**	**695.628**	**116.550**	**569.953**	**530.561**	**464.810**	**465.207**	**465.613**	**466.026**	**1,249.247**	**1,912.692**	**1,861.656**
Net Income to Common (Core)	**346.210**	**331.066**	**366.610**	**344.753**	**480.323**	**581.593**	**569.953**	**530.561**	**464.810**	**465.207**	**465.613**	**466.026**	**1,388.639**	**2,162.430**	**1,861.656**
EPS (GAAP)	**$0.48**	**($0.40)**	**($0.03)**	**$1.83**	**$0.88**	**$0.14**	**$0.60**	**$0.55**	**$0.48**	**$0.48**	**$0.48**	**$0.48**	**$2.04**	**$2.17**	**$1.92**
EPS (Core)	$0.60	$0.59	$0.60	$0.52	$0.61	$0.71	$0.60	$0.55	$0.48	$0.48	$0.48	$0.48	$2.22	$2.45	$1.92
Avg. Fully Diluted Shares	575.860	559.701	611.905	662.477	790.994	827.755	945.000	969.047	969.047	969.047	969.047	969.047	625.307	883.199	969.047
Ending Share Count	559.669	559.764	620.641	631.594	804.351	831.047	969.047	969.047	969.047	969.047	969.047	969.047	631.594	969.047	969.047
Cash dividends declared	**$0.65**	**$0.68**	**$0.68**	**$0.64**	**$0.62**	**$0.65**	$0.60	$0.55	$0.48	$0.48	$0.48	$0.48	**$2.65**	**$2.42**	**$1.92**
Payout (as % of EPS)	108.1%	115.0%	113.5%	123.0%	102.1%	91.2%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	119.3%	98.9%	100.0%
Common Shareholders Equity	9,366.190	9,417.940	9,372.791	9,636.492	12,624.909	13,698.103	16,097.726	16,097.726	16,097.726	16,097.726	16,097.726	16,097.726	9,636.492	16,097.726	16,097.726
Tangible Book Value Per Share	$16.74	$16.82	$15.10	$15.26	$15.70	$16.48	$16.61	$16.61	$16.61	$16.61	$16.61	$16.61	$15.26	$16.61	$16.61
Return on Average Equity (Core)	29.97%	14.30%	15.80%	14.69%	17.41%	17.81%	15.42%	13.29%	11.66%	11.67%	11.68%	11.69%	18.69%	15.98%	11.67%

Source: Company reports, Cantor Fitzgerald estimates.

Disclosures Appendix

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HOLD: We have a neutral outlook on the stock based on our expected 12 month return relative to its risk. The expected return is based on our view of the company and industry fundamentals, catalysts, and valuation.

SELL: We have a negative outlook on the stock based on our expected 12 month return relative to its risk. The expected return is based on our view of the company and industry fundamentals, catalysts, and valuation. We recommend investors reduce their position.

NC: Not Covered. Cantor Fitzgerald does not provide an investment opinion or does not provide research coverage on this stock.

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HOLD - denotes stocks that we suggest will provide a total return or total negative return of up to 15% over 12-month period. A HOLD rated stock is expected to perform in-line with the total average return of the analyst's industry coverage universe on a risk adjusted basis.

SELL - denotes stocks that we expect to provide a total negative return of more than 15% over a 12 month period. A SELL rated stock is expected to underperform the total average return of the analyst's industry coverage universe on a risk adjusted basis.

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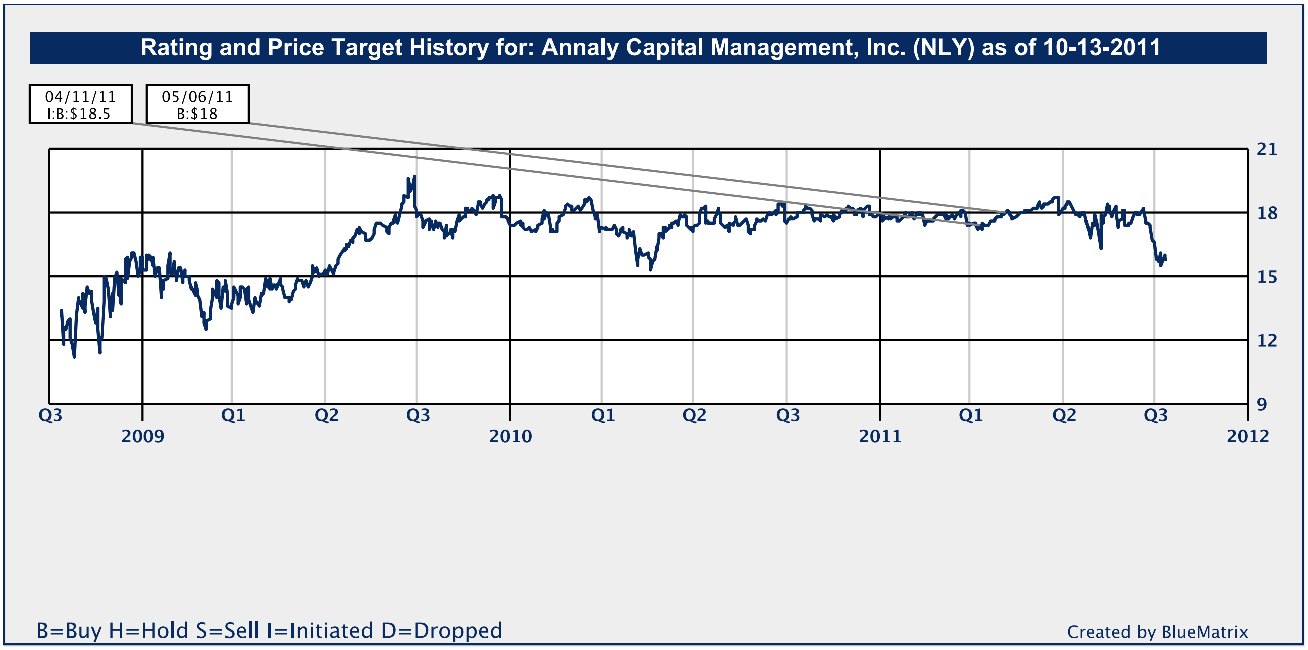

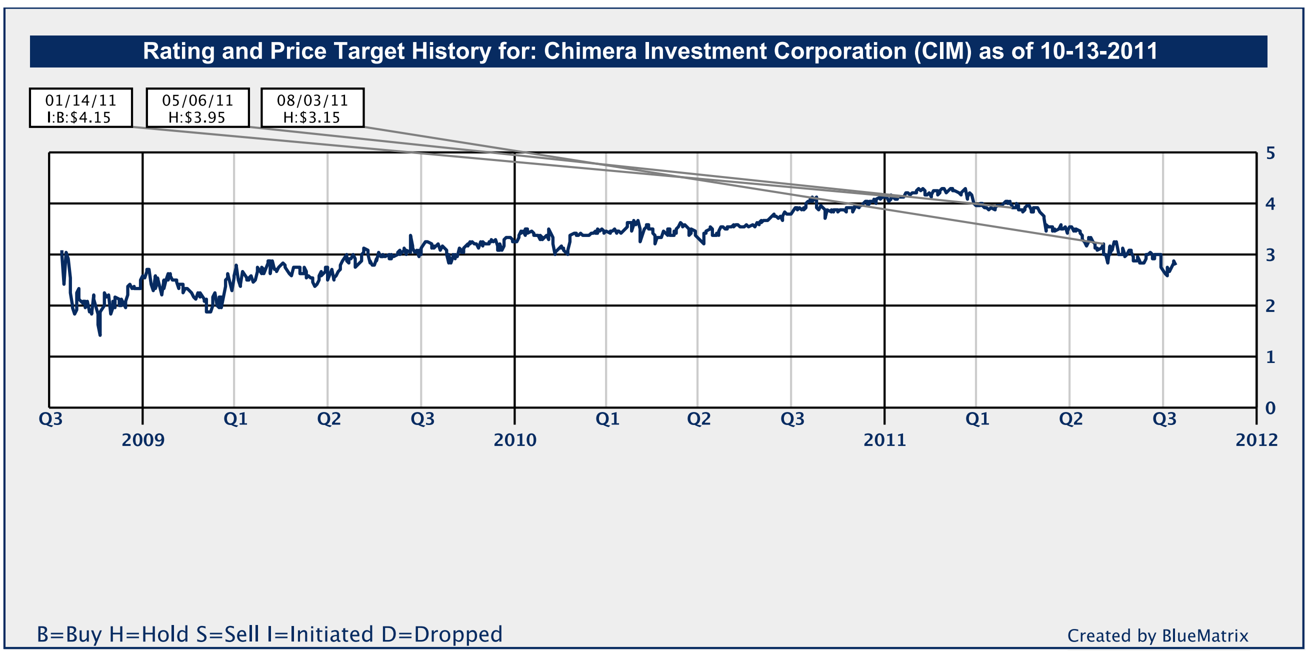

Distribution of Ratings/Investment Banking Services (IB) as of 04/19/11

Cantor

			IB Serv./Past 12 Mos.	
Rating	**Count**	**Percent**	**Count**	**Percent**
BUY [B]	**43**	**61.40**	**10**	**23.26**
HOLD [H]	**21**	**30.00**	**7**	**33.33**
SELL [S]	**6**	**8.60**	**0**	**0.00**

Additional information available on request