Deutsche Bank

1 November 2011

Annaly

Reuters: **NLY.N** Bloomberg: **NLY UN** Exchange: **NYS** Ticker: **NLY**

Lower leverage impacts 3Q earnings; Maintain Buy

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Results

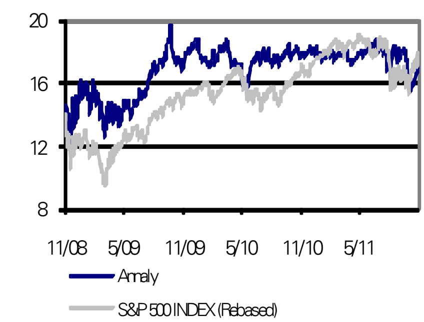
Buy

Price at 1 Nov 2011	**16.66**
Price target	**19.50**
52-week range	**18.72 - 15.48**

Key changes

Price target	20.50 to 19.50 ↓	**-4.9%**
EPS (USD)	2.64 to 2.47 ↓	**-6.4%**

Price/price relative

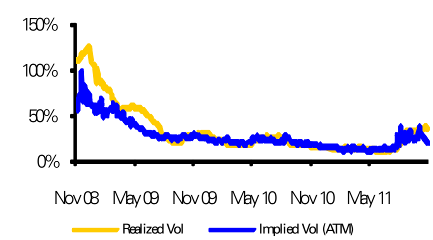


Performance (%)	1m	3m	12m
Absolute	*0.2*	*-4.7*	*-5.7*
S&P 500 INDEX	*7.7*	*-5.3*	*2.9*

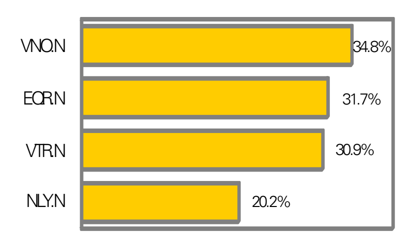
Stock & option liquidity data

Market cap (USDm)	16,175.4
Shares outstanding (m)	970.9
Free float (%)	98
Volume (1 Nov 2011)	3,196,734
Option volume (und. shrs., 1M avg.)	2,601,686

Implied & Realized Volatility (3M)



Implied Volatility (3M, ATM) vs. Peers



*Weighted-avg. of index components
Data as of 31-Oct-11

Maintain Buy given attractive valuation and yield
While 3Q results were below our expectations, it was due to lower leverage as opposed to tighter net interest spreads. We expect Annaly to continue generating attractive returns given the low financing cost environment. While prepayments will likely remain elevated in 4Q and 1Q, we expect earnings to benefit in 2012 as prepayments slow. Additionally, we believe there could be upside to our estimates if leverage increases. We are adjusting our price target to $19.50 from $20.50 per share, and we are maintaining our Buy rating.

3Q results below expectations; Book value decreases to $16.22 per share
Annaly reported 3Q core earnings, excluding unrealized losses on swaps, realized gains, and other income, of $0.56 per share, which were below our estimate of $0.62 per share. The downside was primarily a result of a lower-than-expected leverage (5.5x vs. our est. of 5.7x) and a higher-than-expected share count. The net interest spread of 208 bps beat our estimate of 195 bps. The company reported a GAAP loss of $0.98 per share. Annaly paid a 3Q dividend of $0.60 per share, which decreased sequentially from $0.65 per share. Core earnings including gains on sale of MBS of $0.65 per share covered the 3Q dividend. Book value decreased to $16.22 per share from $16.55 per share.

Conference call on Wednesday, November 2 at 9 AM ET
The dial-in number is 866.843.0890 and the passcode is 2870365.

Decreasing price target to $19.50 per share from $20.50 per share
Given lower portfolio returns near-term from lower leverage and faster prepayments, we are reducing our book value premium to 20% from 25%. We believe our new book value premium is appropriate given our portfolio return expectations. Annaly has historically traded in a range of 0.9x to 1.7x book value.

Annaly manages interest rate and prepayment risks
The primary risks are unexpected changes in interest rates, as an increase in short-term rates would likely increase funding costs while a fall in long-term rates would likely result in an increase in refinance activity and increase amortization expenses. The loss of any key personnel could negatively impact the company. See page 3 for valuation and risk details.

Forecasts and ratios

Year End Dec 31	2010A	**2011E**	2012E
1Q EPS[1]	0.62	**0.62A**	0.57
2Q EPS	0.59	**0.72A**	0.60
3Q EPS	0.60	**0.56A**	0.62
4Q EPS	0.53	**0.57**	0.62
FY EPS (USD)	2.34	**2.47**	2.41
OLD FY EPS (USD)	2.34	**2.64**	2.78
DPS (USD)	2.65	**2.47**	2.40
Dividend Yield (%)	15.1	**14.8**	14.4

Source: Deutsche Bank estimates, company data

[1] Includes the impact of FAS123R requiring the expensing of stock options.

Deutsche Bank Securities Inc.

Additional details

Portfolio update

During 3Q, Annaly reported an annualized yield on average earning assets of 3.71% versus an annualized cost of funds of 1.63%, which resulted in a net interest spread of 208 bps (down sequentially from 245 bps). At the end of 3Q, the yield on average earnings assets was 3.58% vs. cost of funds of 1.62%, resulting in a net interest spread of 196 bps.

During 3Q, Annaly's portfolio increased to $108 billion from $98 billion and consisted of 90% fixed-rate securities, 9% adjustable-rate securities, and 1% LIBOR floating-rate CMOs. However, as a result of swap transactions, the portfolio was effectively 50% fixed-rate securities, 9% adjustable-rate securities, and 41% floating rate securities.

At 3Q end, Annaly's repo borrowings totaled $86 billion, resulting in a leverage of 5.5x, which decreased sequentially from 5.7x. Annaly uses interest rate swaps to protect a portion of its cost of funds against increasing short-term rates. At 3Q end, the company had swaps with notional amount of $41 billion, which amounted to 40% of its repo borrowings.

Reducing estimates

Given 3Q leverage, we are reducing our 2011 and 2012 leverage assumptions, which results in a reduction to our earnings estimates. That said, higher-than-expected leverage could result in upside to our estimates. Additionally, we expect the net interest spread to benefit when prepayments begin to slow, which we anticipate to be in 2Q12.

For 2011, we are decreasing our core earnings estimate to $2.47 per share from $2.64 per share. The decrease is a result of a $0.06 per share downside to 3Q results as well as our lower leverage assumptions in 4Q. We are decreasing our dividend estimate to $2.47 per share from $2.52 per share. Our estimates do not assume any future gain on sale of MBS or any additional equity offerings.

We are decreasing our 2012 core earnings estimate to $2.41 per share from $2.78 per share. We are reducing our 2012 dividend estimate to $2.40 per share from $2.60 per share. Our estimates do not assume any gain on sale of MBS or any additional equity offerings.

Figure 1: Annaly model (in USD millions)

	2010					2011					2012				
FY Ends December	**Q1**	**Q2**	**Q3**	**Q4**	**FY**	**Q1**	**Q2**	**Q3**	**Q4E**	**FY**	**Q1E**	**Q2E**	**Q3E**	**Q4E**	**FY**
Interest Income	654.4	643.7	703.0	682.1	2,683.1	844.0	957.1	930.8	972.5	3,704.4	981.5	1,020.3	1,037.2	1,038.6	4,077.6
Interest Expense	276.5	280.2	302.6	304.0	1,163.3	321.6	330.1	353.3	351.2	1,314.3	360.3	365.3	366.5	367.0	1,459.1
Net Interest Income	377.9	363.4	400.4	378.1	1,519.8	522.4	627.0	577.5	621.3	2,390.1	621.2	655.1	670.7	671.5	2,618.5
Advisory Income, net	12.2	13.9	15.3	16.3	57.7	17.2	20.7	20.8	21.0	79.7	21.3	21.5	21.8	21.8	86.4
Gain on Sale of MBS	47.0	39.0	62.0	33.8	181.8	27.2	7.3	91.7	-	126.2	-	-	-	-	-
Unrealized gain on interest rate swaps	(116.7)	(593.0)	(448.3)	839.2	(318.8)	169.3	(466.9)	(1,505.3)	-	(1,803.0)	-	-	-	-	-
Dividend Income	8.0	7.3	8.1	7.6	31.0	6.3	8.2	8.7	-	23.2	-	-	-	-	-
Other Income	-	0.6	2.0	(2.8)	(0.3)	21.7	(5.5)	(34.6)	-	(18.4)	-	-	-	-	-
Impairment Charge	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
General and Administrative	40.0	41.5	43.4	46.5	171.5	51.8	57.2	65.2	67.5	241.8	68.2	68.9	69.1	69.2	275.5
Pre-Tax Income	288.2	(210.3)	(3.9)	1,225.7	1,299.8	712.3	133.6	(906.4)	574.8	556.1	574.3	607.7	623.3	624.1	2,429.4
Income Tax	7.3	8.8	11.1	8.2	35.4	13.6	12.8	15.4	14.7	56.4	14.9	15.1	15.3	15.3	60.5
Income before Minority Interest	280.9	(219.2)	(14.9)	1,217.5	1,264.3	698.8	120.8	(921.8)	560.1	499.6	559.4	592.6	608.1	608.8	2,368.9
Minority Interest	(0.1)	(0.9)	(0.9)	(1.0)	(2.9)	(1.1)	-	-	-	(1.1)	-	-	-	-	-
Net Income (Loss)	281.1	(218.2)	(14.1)	1,218.5	1,267.3	699.9	120.8	(921.8)	560.1	500.8	559.4	592.6	608.1	608.8	2,368.9
Dividends on Preferred Stock	4.6	4.6	4.5	4.3	18.0	4.3	4.3	4.2	4.2	16.9	4.2	4.2	4.2	4.2	16.7
Net Income to Common Shareholders	276.4	(222.9)	(18.6)	1,214.2	1,249.2	695.6	116.6	(926.0)	555.9	483.9	555.2	588.4	603.9	604.7	2,352.2
Average Shares Outstanding (Diluted)	575.9	582.7	611.9	662.5	625.3	791.0	827.8	948.5	988.5	889.0	989.5	990.5	991.5	992.5	991.0
Core EPS - Diluted	**$ 0.62**	**$ 0.59**	**$ 0.60**	**$ 0.53**	**$ 2.34**	**$ 0.62**	**$ 0.72**	**$ 0.56**	**$ 0.57**	**$ 2.47**	**$ 0.57**	**$ 0.60**	**$ 0.62**	**$ 0.62**	**$ 2.41**
Dividend per Share	$ 0.65	$ 0.68	$ 0.68	$ 0.64	$ 2.65	$ 0.62	$ 0.65	$ 0.60	$ 0.60	$ 2.47	$ 0.60	$ 0.60	$ 0.60	$ 0.60	$ 2.40
Key Metrics															
Earning Assets, average	66,265	68,611	73,457	78,484	71,705	90,202	96,868	103,193	108,056	99,580	109,056	110,306	110,631	110,781	110,193
Common Equity, average	9,568	9,607	9,610	9,726	9,628	11,359	13,391	14,920	15,918	13,897	15,934	15,950	15,966	15,982	15,958
Interest Rate Spread	2.22%	2.16%	2.11%	1.85%	2.07%	2.17%	2.45%	2.08%	2.00%	2.17%	2.00%	2.10%	2.15%	2.15%	2.10%
Debt/Equity Leverage, end of period	5.6x	5.8x	6.3x	6.7x		6.3x	5.7x	5.5x	5.6x		5.7x	5.8x	5.8x	5.8x	
Return on Equity, annualized	16.3%	15.2%	17.6%	15.4%	16.1%	17.7%	17.5%	16.3%	14.1%	16.5%	14.0%	14.9%	15.2%	15.2%	14.8%

Source: Deutsche Bank and company reports

Decreasing price target to $19.50 per share from $20.50 per share

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Annaly manages interest rate and prepayment risks. The primary risks therefore are unexpected changes in interest rates are a risk for Annaly, as an increase in short-term rates would likely increase funding costs while a fall in long-term rates would likely result in an increase in refinance activity. Additionally, liquidity concerns in the Agency MBS market may result in declines in the value of Annaly's portfolio, which could result in margin calls. A company-specific risk is that the entire portfolio is managed from one primary office in NY, with a high concentration of key employees.

Appendix 1

Important Disclosures

Additional information available upon request

Disclosure checklist			
Company	**Ticker**	**Recent price***	**Disclosure**
Annaly	NLY.N	16.66 (USD) 1 Nov 11	1,7

*Prices are sourced from local exchanges via Reuters, Bloomberg and other vendors. Data is sourced from Deutsche Bank and subject companies.

Important Disclosures Required by U.S. Regulators

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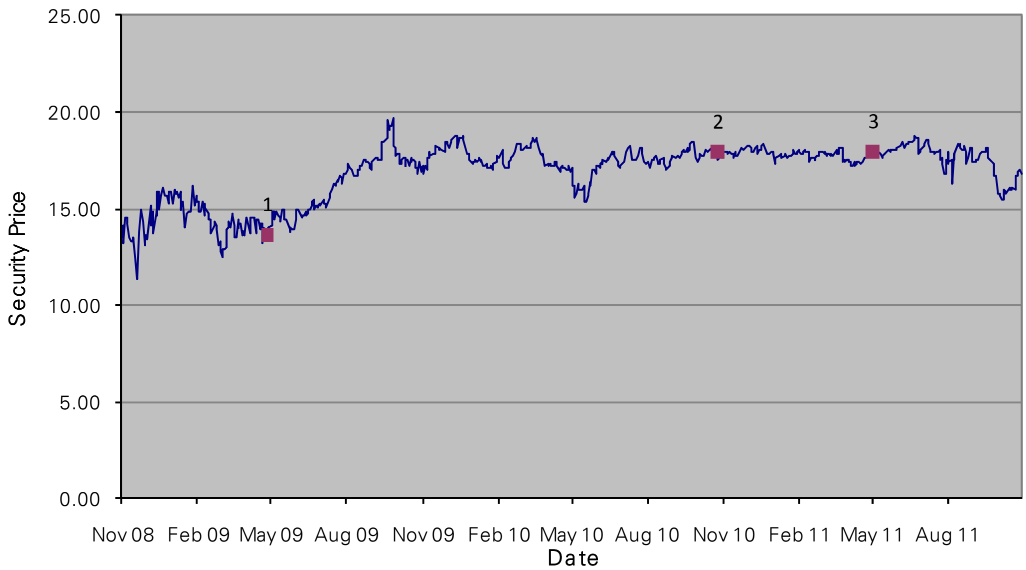
Historical recommendations and target price: Annaly (NLY.N)

(as of 11/1/2011)



Previous Recommendations

Strong Buy
Buy
Market Perform
Underperform
Not Rated
Suspended Rating

Current Recommendations

Buy
Hold
Sell
Not Rated
Suspended Rating

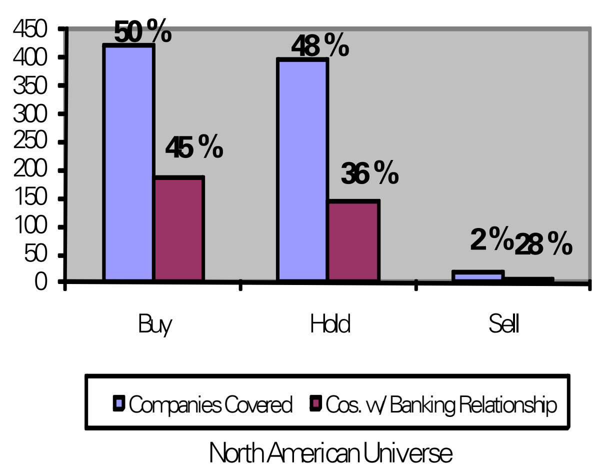
*New Recommendation Structure as of September 9, 2002

1.	4/29/2009:	Buy, Target Price Change USD22.00	3.	5/5/2011:	Buy, Target Price Change USD20.50
2.	10/28/2010:	Buy, Target Price Change USD20.00			

Equity rating key

Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus projected dividend yield) , we recommend that investors buy the stock.
Sell: Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock
Hold: We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.
Notes:
1. Newly issued research recommendations and target prices always supersede previously published research.
2. Ratings definitions prior to 27 January, 2007 were:
Buy: Expected total return (including dividends) of 10% or more over a 12-month period
Hold: Expected total return (including dividends) between -10% and 10% over a 12-month period
Sell: Expected total return (including dividends) of -10% or worse over a 12-month period

Equity rating dispersion and banking relationships



Regulatory Disclosures

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