



COMPANY UPDATE | COMMENT

MAY 3, 2012

American Capital Agency Corp. (NASDAQ: AGNC)
Robust Peer-Leading Returns Expected to Persist:
1Q12 Summary

Outperform
Above Average Risk

Price:	31.65	Price Target:	34.00
Dividend:	5.40	Implied All-In Return:	24%
BVPS:	29.06	Market Cap (MM):	9,495
Float (MM):	299.8	Yield:	17.1%
		P/BVPS:	1.1x
		Tr. 12 ROE:	18.13%
		Avg. Daily Volume (MM):	4.16

Dividend Distribution and Yield based on forward 12-month dividend estimate
 Priced at market close May 3, 2012 ET.

1Q12 GAAP EPS of \$2.66, Core of \$1.30 p/s

1Q12 Overview: AGNC reported GAAP EPS of \$2.66, beating our \$1.26 estimate and a wide ranging consensus (\$1.05 - \$1.43) of \$1.19. Core EPS is estimated at \$1.30. Core EPS benefited from higher than expected asset yields and lower than anticipated borrowing costs along with the successful deployment of proceeds from a recent equity capital raise. We continue to expect performance at AGNC to remain at the upper-end of the peer group for some time ahead.

Spread Expands Nicely in 1Q12: Portfolio spread increased 0.41% to 2.31%, compared 1.90% in 4Q11 and 2.58% in the previous year. Ex-adjustments to lifetime prepayment projections - which we view as a more appropriate measure - spread was 2.13% in 1Q12, up from the 1.97% comparable level in 4Q11. Interest rate spread expansion was driven by higher than anticipated asset yields. Borrowing costs improved 0.15% to 1.01% driven by an increase in the ratio of repo borrowings relative to rate swaps.

Portfolio Rises on Capital Raise Deployment: MBS increased 47% to \$80.6B, from \$54.7B in the prior quarter. Portfolio growth was driven from deployment of newly raised capital. At 1Q12, 96.4% of the portfolio was fixed-rate MBS, 3.1% adjustable rate MBS, and 0.5% in CMOs – clear bias toward fixed-rate MBS, particularly 30-year specified pools. Premium increased modestly sequentially to 104.8% from 104.7%.

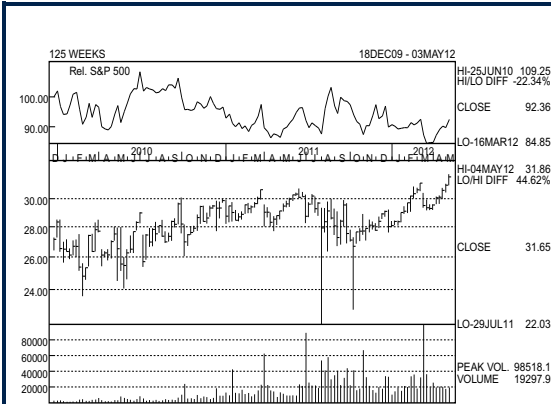
Book Value Benefits from MBS and Swap Upside: Book value increased roughly 5% to \$29.06 p/s, compared to \$27.71 p/s in 4Q11. Book benefited from strong MBS prices, especially in HARP and low loan balance backed pools, along with swap mark gains and equity raise accretion. Management commentary suggests that book value has expanded further in 2Q12.

Estimate Revisions: Increasing our 2012 core EPS estimate to \$5.26 from \$4.90 and increasing our 2013 core EPS estimate to \$5.16 from \$4.76 (\$5.22 including gains). Estimates reflect our outlook for AGNC to generate peer leading upper-teens ROE for the next couple years.

Still Expecting Strong Returns Ahead for AGNC: Valuation is attractive at 1.1x book value relative to our robust 17% forward 12-month dividend yield expectation. We expect strong returns to persist while the curve remains historically very steep.

Priced as of prior trading day's market close, EST (unless otherwise noted).

For Required Conflicts Disclosures, see Page 5.



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FY Dec	2010A	2011A	2012E	2013E
EPS (Op) - FD	4.13	4.93	5.26	5.16
Prev.			4.90	4.76
P/E	7.7x	6.4x	6.0x	6.1x
EPS (Op) - FD	Q1	Q2	Q3	Q4
2010	0.79A	0.98A	1.10A	1.26A
2011	1.30A	1.41A	1.23A	0.98A
2012	1.30A	1.34E	1.31E	1.30E
Prev.	1.22E	1.23E	1.22E	1.23E
2013	1.31E	1.29E	1.28E	1.27E
Prev.	1.21E	1.21E	1.17E	1.17E

EPS (Op): IPO May 20 2008, represents partial quarter results
 EPS (Op): Operating earnings per share, excludes gain on sale of securities, and other non-core items

All values in USD unless otherwise noted.

RBC Capital Markets appreciates your consideration in the All-America Research Institutional Investor Survey.

Details

Earnings Summary: AGNC reported GAAP EPS of \$2.66, above our estimate and a wide ranging consensus (\$1.05 - \$1.43) of \$1.19. Excluding gain on sale of securities (\$216M), gains on derivatives (\$47M), including interest rate swap periodic costs (\$39M) and a non-core benefit from a change in forward-looking prepayment assumptions (roughly \$28M), core EPS is estimated at \$1.30. Core performance benefited from higher than expected portfolio spread, robust in spite of some EPS dilution from the \$2.4B of net equity proceed capital raise.

Portfolio Activity: At the end of 1Q12, assets were up 47% to \$80.6B from \$54.7B in the prior quarter. AGNC's quarter-end leverage increased to 8.0x D/E (excludes MBS payables/receivables), from 7.7x at 4Q11. At 1Q12, the portfolio consisted of 96.4% fixed-rate securities, 3.1% adjustable-rate securities and 0.5% CMOs. The company remains focused on fixed-rate securities (35.4% \leq 15-year fixed rate, 7.3% 20-year fixed rate, and 57.3% 30-year fixed rate MBS), which typically have higher yields but also typically higher interest rate risk – we believe rate risk is not overly concerning at this juncture given AGNC's focus on HARP/low loan balance pools, and we prefer the higher coupons that fixed-rate bonds offer relative to ARMs. Book value increased 4.9% to \$29.06 p/s, from \$27.71 in 4Q11 and relative to \$25.96 in the previous year. Book value was supported by strong MBS prices, hedge mark upside, and equity raise accretion.

Prepayment Speeds Remain Slow: Prepayment speeds came in at 10% CPR, up modestly from 9% at 4Q11 and 13% in the prior year - AGNC's portfolio benefits from high concentration in newer-issue HARP refinanced and low loan balance pools. We expect organic prepays to remain modest relative to the past given that housing market conditions remain challenged, while specified pool focus should remain beneficial as well. Purchase premiums are high relative to most peers at 104.8% of par, though prepay risk in AGNC's book appears relatively controlled at present.

Swaps/Interest Rate Derivatives Offset Risk of Higher rates: During the quarter AGNC increased their swap position by \$7.9 billion, in conjunction with an increase in portfolio size. As of March 31, 2012, swap positions totaled \$38.1 billion, with an average pay-fixed rate of 1.55%. AGNC also added \$8.0 billion of payer swaptions at a cost of \$65M, while \$0.7B payer swaptions expired for a loss of \$5.0 million. At quarter end, the company had \$10.5B in payer swaps outstanding at a market value of \$78 million and an average maturity of 7.2 years. As rates eventually rise, swap positions should help cushion some of the impact on both the value of the portfolio as well as portfolio spread - that said, the larger hedged position could serve to weigh on book value to a degree if swap rates decline further from here. Fed rate hikes are unlikely to begin until late 2014, in our view, and we expect the increases to proceed at a relatively measured pace.

Risk/Return Outlook Remains Attractive: We maintain our positive outlook on AGNC given our outlook for core ROE in the high teens range and strong distributions ahead. Shares are attractive 1.1x book value, with a strong forward 12-month estimated dividend yield of approximately 17%. The company also holds \$1.28 p/s in undistributed REIT taxable income to support dividend payments ahead, bolstering our dividend distribution outlook – undistributed taxable income rose to \$384M from \$180M in the prior quarter. Rate risk at AGNC is elevated relative to peers if prepayment activity accelerates rapidly, although we do not see this as being very likely at this juncture.

Valuation

AGNC currently trades at 6.0x 2012E EPS and 1.1x book value, relative to the peer group averages of 7.1x 2012E EPS and 1.1x book value. Shares will likely continue to trade at a premium to the group given higher than average return expectations, in our view. Our valuation method is two-pronged: First, we believe AGNC shares should trade to yield approximately 15% (50% higher than the historical peer group average) based on our forward 12-month dividend distribution estimate of approximately \$5.40 p/s, suggesting shares are worth roughly \$37. Second, our expectations for an upper-teens percent ROE supports a price-to-book value multiple of approximately 1.2x when viewed from a justified price-to-book valuation basis (which we have adjusted for potential increased risk of holding higher premium bonds in the investment portfolio), in our view. This suggests a fair value of roughly \$32 per share based on our 2012 year-end book value estimate. Combining the two approaches leads us to assign a 12-month price target of \$34 per share.

Price Target Impediment

Our earnings, dividend estimates, and price target could be too high if short-term interest rates move meaningfully higher over the near term without a commensurate increase in longer-term rates, or if long-term interest rates fall dramatically from current levels and residential mortgage prepayments rise significantly. Our earnings, dividend estimates, and price target could be too low if short-term interest rates fall further or more rapidly than expected, and/or spreads on new investments widen. Interest rate volatility could serve to impair book value, which would also likely result in impediment to our price target. Further credit market volatility could also weigh on availability of borrowings or investor sentiment, also impeding our price target. AGNC has above average interest rate risk exposure given higher premium paid for bonds in its portfolio, in our view.

Company Description

American Capital Agency Corp. is an investor in high-quality agency mortgage-backed securities, and is externally managed by a subsidiary of American Capital Strategies. The company's principal business objective is to generate net income for distribution to stockholders, largely driven by the absolute size of its investment portfolio, and the spread between interest income earned on its investment securities and the costs of borrowing used to finance these investments. The company is structured as a real estate investment trust (REIT), which requires it to distribute 90% of taxable income to shareholders.

American Capital Agency Corp																AGNC		
(\$ millions, except per share data and where otherwise noted)																Jason Arnold, CFA - (415) 633-8594		
Source: Company Filings, RBCCM Estimates																		
INCOME STATEMENT	FY08A	FY09A	FY10A	1Q11A	2Q11A	3Q11A	4Q11A	FY11A	1Q12A	2Q12E	3Q12E	4Q12E	FY12E	1Q13E	2Q13E	3Q13E	4Q13E	FY13E
Mortgage-Backed Securities Income	55.1	\$127.9	\$253.0	164.5	264.7	326.8	352.9	\$1,108.9	514.0	596.3	579.8	573.6	\$2,263.8	580.8	571.5	569.6	564.5	\$2,286.4
Interest Expense on Borrowed Funds	24.9	43.5	76.0	35.6	63.8	95.0	90.1	284.6	106.0	176.4	169.7	168.2	620.2	170.3	168.2	168.2	166.7	673.4
Net Interest Income	30.2	84.4	177.0	128.8	200.9	231.7	262.8	824.3	408.0	420.0	410.2	405.4	1,643.6	410.5	403.3	401.4	397.8	1,613.0
Non-Interest Income/Other	10.9	45.7	130.4	15.7	(6.1)	41.3	(24.5)	26.3	263.0	10.0	10.0	10.0	293.0	5.0	5.0	5.0	5.0	20.0
Total Income	41.1	130.1	307.4	144.6	194.8	273	238.3	850.6	671.0	430.0	420.2	415.4	1,936.6	415.5	408.3	406.4	402.8	1,633.0
Management Fee	2.2	4.7	11.3	8.5	12.4	15.6	18.3	54.8	22.0	8.6	8.6	8.6	47.8	8.6	8.6	8.6	8.6	34.4
Other non-operating expenses	3.5	6.5	8.0	2.6	4.5	6.9	11.2	25.3	8.0	8.0	8.0	8.0	32.0	8.0	8.0	8.0	8.0	32.0
Net Income	\$35.4	\$118.6	\$288.1	\$133.5	\$177.8	\$250.4	\$208.7	\$770.5	\$641.0	\$413.4	\$403.6	\$398.8	\$1,856.8	\$398.9	\$391.7	\$389.8	\$386.2	\$1,566.7
Extraordinary Gains/(Losses)	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	(\$13.0)	\$26.3	\$13.3	\$64.0	\$0.0	\$0.0	\$0.0	\$64.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Operating Net Income	\$35.4	\$118.6	\$288.1	\$117.8	\$183.9	\$222.1	\$207.0	\$757.2	\$314.0	\$403.4	\$393.6	\$388.8	\$1,792.8	\$393.9	\$386.7	\$384.8	\$381.2	\$1,566.7
Preferred Stock	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Operating Net Income to Common	\$35.4	\$72.9	\$288.1	\$117.8	\$183.9	\$222.1	\$207.0	\$757.2	\$314.0	\$403.4	\$393.6	\$388.8	\$1,792.8	\$393.9	\$386.7	\$384.8	\$381.2	\$1,566.7
Avg. Shares Outstanding	15.0	17.5	36.5	90.3	130.5	180.7	210.3	153.3	241.0	300.0	300.0	300.0	285.3	300.0	300.0	300.0	300.0	300.0
GAAP Earnings Per Share	\$2.36	\$6.78	\$7.89	\$1.48	\$1.36	\$1.39	\$0.99	\$5.02	\$2.66	\$1.38	\$1.35	\$1.33	\$6.71	\$1.33	\$1.31	\$1.30	\$1.29	\$5.22
Operating EPS to Common	\$1.67	\$4.04	\$4.13	\$1.30	\$1.41	\$1.23	\$0.98	\$4.93	\$1.30	\$1.34	\$1.31	\$1.30	\$5.26	\$1.31	\$1.29	\$1.28	\$1.27	\$5.16
Dividends Per Share	\$2.51	\$5.15	\$5.60	\$1.40	\$1.40	\$1.40	\$1.40	\$5.60	\$1.25	\$1.25	\$1.25	\$1.65	\$5.40	\$1.25	\$1.25	\$1.25	\$1.40	\$5.15
Payout Ratio	107%	128%	136%	95%	103%	101%	141%	114%	47%	91%	93%	124%	103%	94%	96%	96%	109%	100%
BALANCE SHEET	FY08A	FY09A	FY10A	1Q11A	2Q11A	3Q11A	4Q11A	FY11A	1Q12A	2Q12E	3Q12E	4Q12E	FY12E	1Q13E	2Q13E	3Q13E	4Q13E	FY13E
Assets:																		
Agency Mortgage-Backed Securities	1,604	4,389	13,252	28,193	39,926	41,970	54,683	54,683	80,570	77,399	76,202	78,829	78,829	79,224	78,430	77,618	75,469	75,469
Cash & Equivalents	56	203	173	301	626	1,285	1,468	1,468	1,762	1,762	1,762	1,762	1,762	1,762	1,762	1,762	1,762	1,762
Total Interest Earning Assets	1,629	4,503	13,684	28,493	40,552	43,256	56,151	56,151	82,332	79,161	77,964	80,591	80,591	80,986	80,192	79,380	77,231	77,231
Liabilities:																		
Repurchase Agreements	1,346	3,842	11,680	21,994	33,505	38,842	47,681	47,681	69,816	68,502	67,237	70,070	70,070	70,422	69,715	68,994	67,084	67,084
Total Shareholders Common Equity	258	547	1,572	3,345	4,777	4,940	6,212	6,212	8,718	8,896	8,965	8,759	8,759	8,803	8,714	8,624	8,385	8,385
Total Shareholders Tangible Equity	258	547	1,572	3,345	4,777	4,940	6,212	6,212	8,718	8,896	8,965	8,759	8,759	8,803	8,714	8,624	8,385	8,385
Leverage (Debt/Total Equity)	5.2x	7.3x	7.5x	6.6x	7.0x	7.9x	7.7x	7.7x	8.0x	7.7x	7.5x	8.0x	8.0x	8.0x	8.0x	8.0x	8.0x	8.0x
Debt/Equity	5.2x	7.0x	7.4x	6.6x	7.0x	7.9x	7.7x	7.7x	8.0x	7.7x	7.5x	8.0x	8.0x	8.0x	8.0x	8.0x	8.0x	8.0x
Book Value Per Share	\$ 17.20	\$ 22.48	\$ 24.24	\$ 25.96	\$ 26.76	\$ 26.90	\$ 27.71	\$ 27.71	\$ 29.06	\$ 29.65	\$ 29.88	\$ 29.20	\$ 29.20	\$ 29.34	\$ 29.05	\$ 28.75	\$ 27.95	\$ 27.95
PROFITABILITY / EFFICIENCY	FY08A	FY09A	FY10A	1Q11A	2Q11A	3Q11A	4Q11A	FY11A	1Q12A	2Q12E	3Q12E	4Q12E	FY12E	1Q13E	2Q13E	3Q13E	4Q13E	FY13E
Yield on Average Earning Assets	5.08%	4.77%	3.48%	3.39%	3.35%	3.14%	3.06%	3.24%	3.32%	3.02%	3.02%	2.96%	3.08%	2.94%	2.90%	2.92%	2.95%	2.93%
Cost of Borrowings	2.62%	1.80%	1.20%	0.81%	0.89%	1.00%	1.16%	0.97%	1.01%	1.02%	1.00%	0.98%	1.00%	0.97%	0.96%	0.97%	0.98%	0.97%
Net Interest Rate Spread	2.46%	2.97%	2.28%	2.58%	2.46%	2.14%	1.90%	2.27%	2.31%	2.00%	2.02%	1.98%	2.08%	1.97%	1.94%	1.95%	1.97%	1.96%
G&A/Average Earning Assets	0.16%	0.16%	0.14%	0.13%	0.12%	0.15%	0.14%	0.14%	0.13%	0.04%	0.04%	0.04%	0.06%	0.04%	0.04%	0.04%	0.04%	0.04%
ROAE, Core (a)	15.8%	19.8%	16.7%	15.3%	18.1%	18.3%	14.3%	16.5%	17.8%	18.3%	17.6%	17.6%	17.8%	18.0%	17.7%	17.8%	17.9%	17.8%

Notes: (A) Actual, (E) Estimates. (a) Annualized

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Conflicts Disclosures

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RBC Capital Markets has provided American Capital Agency Corp. with investment banking services in the past 12 months.

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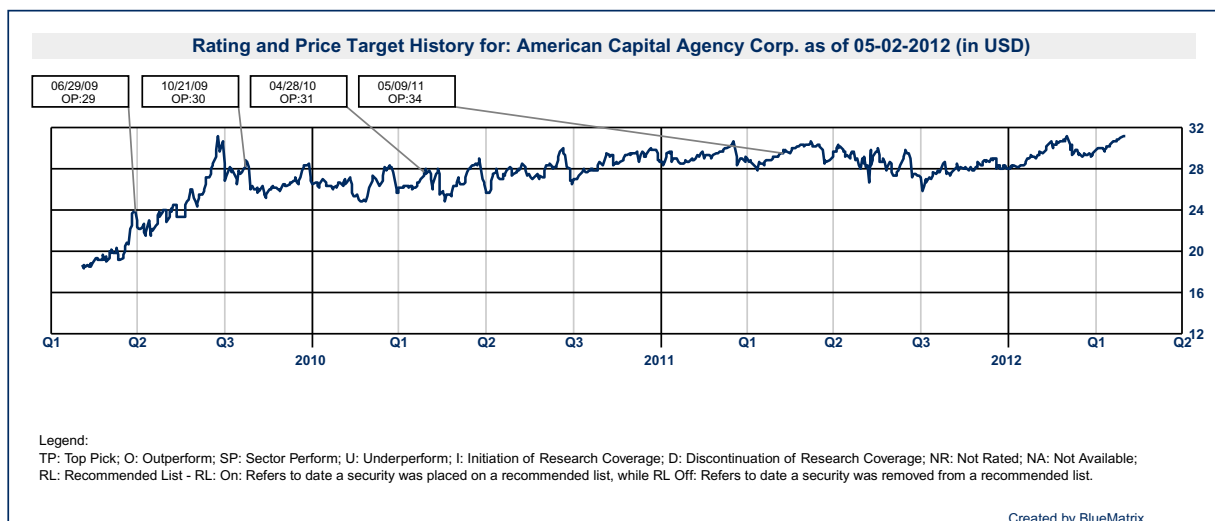
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Distribution of Ratings RBC Capital Markets, Equity Research				
Rating	Count	Percent	Investment Banking Serv./Past 12 Mos.	
			Count	Percent
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HOLD[SP]	653	43.85	154	23.58
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