Sung Nam
October 15, 2012

Chimera Investment Co. (CHI) Part 1

RMBS focused investment co. managed and advised by Anally Capital Management. Anally has been in business since 1997 and has a logical network of subsidiary operations, in warehouse lending, corporate mortgage investing, middle market lending, investment advisory, and RMBS brokerage. Annally has made a name for itself in the RMBS space. The co. invests primarily in non-agency RMBS (82% of portfolio), agency RMBS (12% of portfolio) and securitized residential mortgage loans (4%). Also, the co. works with originators of the loans and structures securities with the co. holding on to the mezzanine and subordinate tranche. The co. maintains a REIT structure, so the coupon, or interest payments received on the securities are mainly remitted to the shareholders, at least 90%.

RMBS are pass-thru securities where the mortgage payments are transmitted directly to the RMBS holders net of servicing fees. They also purchase residential loans from originators or in the secondary market. One example might be a non-agency, or not conforming to Freddie, Fannie, GNMA standards, and normally held by the originating bank. Let's assume the notional mortgage amount is $5M and the mortgagee, or the borrower, is a rich lawyer who has plenty of liquid assets and the property itself may have a value of $10 MM, or more than double the loan value. CHI would feel comfortable purchasing the loan which yields 6% for a 20 year fix, if the cost of borrowing for CHI is less than 6%. The loan would normally be a 1st lien, less than 40 year maturity, and fully amortizing, or principal fully paid back by maturity, or amortizing after 10 years.

If we were a RMBS portfolio manager, we would try to diversify the securities by geography, mainly purchasing low yielding securities in the historically stronger real estate markets, while taking a smaller portion of our investable cash and investing the money in weaker, distressed markets trading at a discount, to capture the alpha piece.

The yield on the investments has been around 9%, while the cost of funding is 4%, so the co. has enjoyed a 5% net interest margin (NIM) for the past 2 years. 0.75% management fee.

	Net Interest Income							
	Average Earning Assets Held *	Interest Earned on Assets *	Yield on Average Interest Earning Assets	Average Debt Balance	Interest Expense	Average Cost of Funds	Net Interest Income	Net Interest Rate Spread
	(Ratios have been annualized, dollars in thousands)							
December 31, 2010	$ 8,479,109	$ 755,398	8.91%	$ 3,793,049	$ 152,236	4.01%	$ 603,202	4.90%
December 31, 2009	$ 4,328,892	$ 298,539	6.90%	$ 1,724,698	$ 35,083	2.03%	$ 263,456	4.87%
December 31, 2008	$ 1,711,705	$ 102,093	5.96%	$ 1,304,873	$ 60,544	4.64%	$ 44,715	1.32%

The subscription into the fund raises capital and we noticed a $2.3B non-agency, senior, non-retained debt, which was used as collateral for the securitized debt that grew simultaneously grew the asset/debt, like a spot and offsetting forward. In other words, they bought a portfolio of non-agency senior mortgages with repo agreements and securitized them and packaged them to sell to other investors. So, they own $2 BB in mortgages, but they are also obligated to pay back investors $2 which was sold. Use repo agreements at a rate around 1% for the interim financing. They get about a 1% NIM from the secured debt, which is $20MM for a $2 BB balance.