

DYNEX CAPITAL INC
Form DEF 14A
March 29, 2004
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SCHEDULE 14A INFORMATION
Proxy Statement Pursuant to Section 14(a) of the
Securities Exchange Act of 1934

Filed by the Registrant Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
- Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material Pursuant to §240.14a-12

DYNEX CAPITAL, INC.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

- No fee required.
- Fee computed on table below per Exchange Act Rules 14a-6(i)(4) and 0-11.

(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

(4) Proposed maximum aggregate value of transaction:

(5) Total fee paid:

Fee paid previously with preliminary materials.

Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offset fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

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NOTE: THE TRANSACTIONS THAT ARE THE SUBJECT OF THE PROXY STATEMENT CONTAINED IN THIS SCHEDULE 14A ARE GOVERNED BY SEC RULE 13E-3 AND ARE ALSO THE SUBJECT OF A SEPARATE FILING BY THE REGISTRANT ON A COMBINED SCHEDULE TO/13E-3 THAT HAS BEEN FILED WITH THE SECURITIES AND EXCHANGE COMMISSION CONTEMPORANEOUSLY HEREWITH.

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March 29, 2004

To Our Preferred Stockholders:

You are cordially invited to attend a special meeting of Preferred Stockholders of Dynex Capital, Inc. The meeting will be held at Dynex Capital's corporate offices located at 4551 Cox Road, Suite 300, Glen Allen, Virginia, on Thursday, April 29, 2004 at 2:00 p.m., Eastern time.

At the special meeting, you will be asked to consider and vote upon an important transaction that is aimed at simplifying and improving Dynex Capital's capital structure. The transaction involves the automatic conversion of the outstanding shares of each of our series of Preferred Stock (Series A, Series B and Series C) into shares of a new Series D Preferred Stock, with an additional payout of shares of our Common Stock and cash consideration in lieu of any fractional shares of Series D Preferred Stock and Common Stock (the Series D conversion).

The Series D conversion will be accomplished through an amendment of Dynex Capital's articles of incorporation to:

1. designate and establish the terms of the new Series D Preferred Stock, and
2. eliminate the Series A Preferred Stock, Series B Preferred Stock and Series C Preferred stock by providing for the automatic conversion of those shares into Series D Preferred Stock and Common Stock.

The adoption of the amendment that will implement the Series D conversion will require the approval at the special meeting of the holders of two-thirds of the outstanding shares of each of the three series of Preferred Stock.

Concurrently with the mailing of the accompanying proxy statement, Dynex Capital is commencing an exchange offer (the Note Offer) through an offering circular distributed with this letter and the accompanying proxy statement to all holders of Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock (collectively, the Preferred Stockholders). The Note Offer and the Series D conversion are components of an overall recapitalization of Dynex Capital's capital structure. In the Note Offer, Dynex Capital is seeking tenders of up to approximately 70% of the outstanding shares of Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock in exchange for a new series of 9.50% Senior Notes. If the Series D conversion is approved at the special meeting, both the Note Offer and the Series D conversion are expected to close and become effective as soon as practicable following the special meeting. As a Preferred Stockholder, you are encouraged to carefully read the offering circular and the related letter of transmittal.

Dynex Capital is proposing the Series D conversion because it believes:

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The elimination of the dividend arrearages in the three separate series of Preferred Stock, the replacement of three series of Preferred Stock with a single series, and the reduction in the overall amount of Preferred Stock outstanding, will simplify Dynex Capital's capital structure

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and should create improved opportunities for Dynex Capital to engage in strategic transactions, access the capital markets, and/or reinvest in business activities.

The holders of Preferred Stock whose shares will be converted will receive a security instrument that includes stronger covenants in the event Dynex Capital fails to pay future dividends (or otherwise falls below certain financial thresholds) and a guaranty of future board of directors representation.

The improved conversion features of the Series D Preferred Stock will create greater opportunities for the holders of Preferred Stock to participate in any future success in the Company's business strategies by lowering the conversion price into Common Stock from \$48 or higher to \$10 per share of Common Stock.

The conversion of the three series of Preferred Stock into Series D Preferred Stock, the elimination of the dividend arrearage, and the payment of dividends on Series D Preferred Stock will likely enhance the market liquidity of Series D Preferred Stock relative to the existing liquidity of the three separate series of Preferred Stock.

The holders of Common Stock will benefit from a capital structure that commits fewer long-term resources to the payment of Preferred Stock dividends and that reduces the liquidation preference held by the holders of Preferred Stock primarily through the issuance of additional Common Stock.

A committee of the board of directors reviewed and considered the terms of the recapitalization and unanimously recommended the approval of those terms, including the proposed Series D conversion, to the board of directors. The board of directors has determined that the recapitalization is both substantively and procedurally fair to Dynex Capital's unaffiliated Preferred Stockholders of each series and unaffiliated Common Stockholders and is advisable and in the best interests of Dynex Capital and its stockholders, and recommends that Dynex Capital's Preferred Stockholders vote in favor of the Series D conversion.

The board of directors did not retain the services of a financial advisor to render an opinion as to the fairness of the recapitalization transaction, but reached an independent determination that the transaction, including the Series D conversion, is substantively and procedurally fair to Dynex Capital's unaffiliated Preferred Stockholders of each series and unaffiliated Common Stockholders. Among other factors, the board of directors took into account the fact that all holders of each series of Preferred Stock, and the three series of Preferred Stock collectively, will be treated equally in the Series D conversion and will receive an equal premium to the original issue price of their shares in the form of new Series D Preferred Stock and Common Stock, and the fact that the Series D conversion cannot be approved by the holders of the Preferred Stock unless a majority of the holders of the Preferred Stock who are unaffiliated with members of the board of directors vote in favor of the Series D conversion. Dynex Capital did not retain an independent advisor to represent the interests of unaffiliated stockholders.

The board of directors unanimously recommends that you vote FOR the proposal to amend our articles of incorporation.

Even if the preferred stockholders approve the Series D conversion, we may not complete the recapitalization if any of several other conditions are not satisfied. These conditions include:

The approval by our Common Stockholders of the issuance of shares of Common Stock in connection with the recapitalization; and

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The tender by our Preferred Stockholders of shares of Preferred Stock that will result in the issuance of at least \$10,000,000 in principal amount of new Senior Notes.

Information about the special meeting of holders of Preferred Stock and the business to be considered and voted upon at the special meeting is included in the accompanying notice of special meeting and proxy statement. These materials include a summary of the recapitalization, including the Series D conversion, and additional information about the parties involved and their interests in the recapitalization, including the Series D conversion. We encourage you to read and consider carefully the information contained in the proxy statement. In addition, you may find additional information about our company from documents we have filed with the Securities and Exchange Commission (SEC), including our combined Issuer Tender Offer Statement and Rule 13e-3 Transaction Statement filed on Schedule TO with the SEC.

Your vote is important regardless of the number of shares you own, and regardless of whether you plan to tender your shares in the Note Offer. ***We urge you to complete, sign, date and return the enclosed proxy card(s) as soon as possible, even if you currently plan to attend the meeting.*** Returning a proxy card will not prevent you from attending the special meeting and voting in person, but will ensure that your vote is counted if you are unable to attend the meeting.

Thank you for your interest and participation.

Sincerely,

/s/ THOMAS B. AKIN

Thomas B. Akin

Chairman of the Board

/s/ STEPHEN J. BENEDETTI

Stephen J. Benedetti

Executive Vice President and Chief Financial Officer

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of the Series D conversion or the Note Offer, passed upon the merits or fairness of the Series D conversion or the Note Offer, or passed upon the adequacy or accuracy of the disclosure in this proxy statement. Any representation to the contrary is a criminal offense.

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4551 Cox Road, Suite 300

Glen Allen, Virginia 23060

(804) 217-5800

NOTICE OF SPECIAL MEETING OF PREFERRED STOCKHOLDERS

To Our Preferred Stockholders:

Notice is hereby given that a special meeting of Preferred Stockholders of Dynex Capital, Inc. will be held at Dynex Capital's corporate offices located at 4551 Cox Road, Suite 300, Glen Allen, Virginia, on Thursday, April 29, 2004 at 2:00 p.m., Eastern time for the following purposes:

1. To approve an amendment of Dynex Capital's articles of incorporation to: (a) designate and establish the terms of a new Series D Preferred Stock and (b) eliminate the Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock and provide for their automatic conversion into Series D Preferred Stock and Common Stock (the "Series D conversion").
2. To approve adjournments of the special meeting in order to allow Dynex Capital to continue to solicit proxies from holders of Preferred Stock who have not cast a vote by proxy with respect to the approval of the amendment, or whose proxies have not been voted in favor of the amendment.
3. To transact such other business as may properly come before the meeting or any adjournment or postponement thereof. The board of directors is not aware of any other business to come before the special meeting.

These proposals are more fully described in the proxy statement that accompanies this notice. Please read the proxy statement carefully when determining how to vote on these proposals.

Concurrently with the mailing of the accompanying proxy statement, Dynex Capital is commencing an exchange offer (the "Note Offer") through an offering circular distributed with this notice and the accompanying proxy statement to all holders of Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock (collectively, the "Preferred Stockholders"). In the Note Offer, Dynex Capital is seeking tenders of up to approximately 70% of the outstanding shares of Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock in exchange for a new series of 9.50% Senior Notes. As a Preferred Stockholder, you are encouraged to carefully read the offering circular and the related letter of transmittal.

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Adoption of the amendment to the articles of incorporation effecting the Series D conversion requires the approval at the special meeting of the holders of two-thirds of the outstanding shares of each of the three series of Preferred Stock. If the proposed amendment is approved at the special meeting, the Note Offer and the Series D conversion are expected to close and become effective as soon as practicable following the special meeting. If the Series D conversion is not approved, then neither the Note Offer nor the Series D conversion, as currently proposed, will be implemented.

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The board of directors has fixed the close of business on March 5, 2004 as the record date for the determination of stockholders entitled to notice of and to vote at the special meeting and at any adjournment or postponement thereof.

After careful consideration as to the fairness of the recapitalization, from a financial point of view, to Dynex Capital's unaffiliated Preferred Stockholders and unaffiliated Common Stockholders, including the exchange ratios relating to the Senior Notes offered in the Note Offer and the Series D Preferred Stock and Common Stock offered in the Series D conversion, Dynex Capital's board of directors determined that the Note Offer and the Series D conversion are substantively and procedurally fair to Dynex Capital's unaffiliated Preferred Stockholders of each series and unaffiliated Common Stockholders and are advisable and in the best interests of Dynex and its stockholders, and directed that the amendment of Dynex Capital's articles of incorporation be submitted to Dynex Capital's Preferred Stockholders for their approval. Dynex Capital's board of directors recommends that you vote FOR the amendment.

One or more proxy cards accompany this notice of special meeting and the proxy statement. **Whether or not you expect to attend the special meeting or to tender your shares in the Note Offer, please complete, sign and date the enclosed proxy card(s) and return them promptly.** If you plan to attend the special meeting and wish to vote your shares personally, you may do so at any time before the proxies are voted.

All Preferred Stockholders are cordially invited to attend the meeting.

By Order of the Board of Directors

/s/ STEPHEN J. BENEDETTI

Stephen J. Benedetti

Secretary

Glen Allen, Virginia

March 29, 2004

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Appendix A Amendment to Articles of Incorporation

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SUMMARY TERM SHEET

This summary term sheet highlights selected material information from this proxy statement, but may not contain all of the information that is important to you. To better understand the Series D conversion, and for a more complete description of its terms, you should carefully read this entire proxy statement and its appendices and the other documents referred to in this proxy statement. The actual terms of the Series D conversion are contained in the proposed amendment to the Dynex Capital articles of incorporation included in this proxy statement as Appendix A. When used in this proxy statement, the terms Company, Dynex Capital, we, our, ours and us refer to Dynex Capital, Inc. and its consolidated subsidiaries, unless otherwise specified or the context requires otherwise. The term unaffiliated when used in the phrase unaffiliated holders of Common Stock or unaffiliated holders of Preferred Stock means shareholders who are not directors or officers of Dynex Capital, and who are not persons or entities affiliated with any director or officer of Dynex Capital.

QUESTIONS AND ANSWERS ABOUT THE PROXY MATERIALS AND THE SERIES D CONVERSION

What Is Dynex Capital Seeking to Accomplish?

Dynex Capital is seeking to recapitalize its capital structure. We seek to accomplish this recapitalization through two steps: (1) an offer to exchange your shares of Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock for new 9.50% Senior Notes, as disclosed in a separate offering circular (the Note Offer) and (2) an amendment to our articles of incorporation that will eliminate all shares of Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock not tendered and accepted by us in the Note Offer and through the conversion of all such shares of Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock into a new Series D Preferred Stock (the Series D conversion). The Series D conversion is described in detail in this proxy statement.

What Transactions Are Involved in the Series D Conversion?

This proxy statement describes a transaction in which holders of each of our three series of Preferred Stock are being asked to vote to amend our articles of incorporation so that following the amendment we will have a single series of Series D Preferred Stock. If the amendment to our articles of incorporation is approved by the holders of two-thirds of the outstanding shares of each of the three series of Preferred Stock, the outstanding shares of each series of Preferred Stock will automatically be converted into shares of our Series D Preferred Stock. Holders of the existing Preferred Stock whose shares are converted into Series D Preferred Stock will also receive, as part of the conversion, shares of our Common Stock, and may receive cash in lieu of fractional shares of Series D Preferred Stock and Common Stock.

The Series D conversion is part of a recapitalization plan that also includes a separate Note Offer to exchange Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock for our new 9.50% Senior Notes. The Note Offer is described more completely in the separate offering circular accompanying this proxy statement. You are encouraged to read the offering circular carefully.

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Because the Note Offer would be expected to be completed immediately before we file the amendment to our articles of incorporation that will create the Series D Preferred Stock, the Series D conversion that is part of the recapitalization will occur only with respect to shares of our existing Preferred Stock that are not tendered to and accepted by us in exchange for Senior Notes in the Note Offer. For more information about the terms of the conversion of the existing Preferred Stock, see Proposal: Amendment of Dynex Capital's Articles of Incorporation to Accomplish Series D Conversion.

Is Dynex Capital Willing To Complete Only Part of the Recapitalization?

No. If the Series D conversion is not approved, we will not consummate any portion of the Note Offer. Likewise, if the amount of Senior Notes to be issued to tendering stockholders is not at least \$10 million, we do not intend to complete either the Note Offer or the Series D conversion.

What Will I Receive if the Series D Conversion is Approved?

If the Series D conversion is approved, each share of Preferred Stock that is not tendered and accepted in connection with the Note Offer will be automatically converted into a combination of Series D Preferred Stock and shares of Common Stock, plus an amount of cash necessary to account for any fractional shares of Series D Preferred Stock or Common Stock that would result from the conversion.

The conversion ratio for each of the Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock is based on the issuance of Series D Preferred shares with an original issue price equal to 116% of the original issue price of each of the original series of Preferred Stock, plus shares of Common Stock having a value equal to 15% of the original issue price of the Preferred Stock (with the value of the Common Stock based on the average closing price of the Common Stock as traded on the New York Stock Exchange for the 50 trading days prior to the announcement of the Note Offer and the Series D conversion on January 8, 2004). The original per share issue price of the Series A Preferred Stock was \$24.00, the original per share issue price of the Series B Preferred Stock was \$24.50, and the original per share issue price of the Series C Preferred Stock was \$30.00. The original per share issue price for the Series D Preferred Stock will be \$10.00, and the average per share price of the Common Stock for the 50-trading-day period prior to January 8, 2004 was \$5.6484.

Accordingly, as an example, a holder of 100 shares of the Series A Preferred Stock, Series B Preferred Stock, or Series C Preferred Stock would receive the following upon the conversion of his original shares:

Original Shares Held	Number of Shares of Series D Preferred Stock to be Issued	Aggregate Liquidation Value of Series D Preferred Stock to be Issued	Number of Shares of Common Stock to be Issued	Cash payment in Lieu of Fractional Shares
100 shares of Series A Preferred Stock	278	\$ 2,780	63	\$ 8.12
100 shares of Series B Preferred Stock	284	\$ 2,840	65	\$ 2.34
100 shares of Series C Preferred Stock	348	\$ 3,480	79	\$ 3.78

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See Proposal: Amendment of Dynex Capital's Articles of Incorporation to Accomplish Series D Conversion Basis of the Conversion.

What are the Principal Differences in the Terms of the Existing Series of Preferred Stock and the New Series D Preferred Stock?

The new Series D Preferred Stock will contain different dividend, conversion, liquidation, voting, redemption and other terms than the existing Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock. The principal differences are as follows:

	Series A	Series B	Series C	Series D
Dividends	9.75% annual rate	9.55% annual rate	9.73% annual rate	9.50% annual rate
Liquidation Preference	\$24.00 per share plus accrued but unpaid dividends	\$24.50 per share plus accrued but unpaid dividends	\$30.00 per share plus accrued but unpaid dividends	\$10.00 per share plus accrued but unpaid dividends
Conversion	Presently convertible on the basis of one share of Common Stock for each two shares of Series A Preferred	Presently convertible on the basis of one share of Common Stock for each two shares of Series B Preferred	Presently convertible on the basis of one share of Common Stock for each two shares of Series C Preferred	Convertible on the basis of one share of Common Stock for each share of Series D Preferred
Redemption	Redeemable upon the call of Dynex Capital (i) in shares of Common Stock at a rate of two shares of Series A Preferred for one share of Common Stock, excluding any accrued and unpaid dividends which are to be paid in cash, provided that the closing price of the Common Stock has exceeded \$48.00 per share for 20 of 30 trading days, or (ii) for cash in the amount of \$24.00 per share, plus all accumulated, accrued and unpaid dividends	Redeemable upon the call of Dynex Capital (i) in shares of Common Stock at a rate of two shares of Series B Preferred for one share of Common Stock, excluding any accrued and unpaid dividends which are to be paid in cash, provided that the closing price of the Common Stock has exceeded \$49.00 per share for 20 of 30 trading days, or (ii) for cash in the amount of \$24.50 per share, plus all accumulated, accrued and unpaid dividends	Redeemable upon the call of Dynex Capital (i) in shares of Common Stock at a rate of two shares of Series C Preferred for one share of Common Stock, excluding any accrued and unpaid dividends which are to be paid in cash, provided that the closing price of the Common Stock has exceeded \$60.00 per share for 20 of 30 trading days, or (ii) for cash in the amount of \$30.00 per share, plus all accumulated, accrued and unpaid dividends	Redeemable upon the call of Dynex Capital (i) in shares of Common Stock at a rate of one share of Series D Preferred for one share of Common Stock, excluding any accrued and unpaid dividends which are to be paid in cash, provided that the closing price of the Common Stock has exceeded \$10.00 per share for 20 of 30 trading days, or (ii) for cash in the amount of \$10.00 per share, plus all accumulated, accrued and unpaid dividends

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Voting Rights	Right shared with holders of other two series of Preferred Stock to elect two directors whenever Dynex Capital has failed to pay six quarterly dividends or has failed to maintain shareholders equity at the end of any calendar quarter of \$80 million. The right to elect these directors terminates whenever dividend arrearages are brought current and/or Dynex Capital satisfies the shareholders equity test	Right shared with holders of other two series of preferred stock to elect two directors whenever Dynex Capital has failed to pay six quarterly dividends or has failed to maintain shareholders equity at the end of any calendar quarter of at least 150% of the aggregate liquidation preference of the three series of Preferred Stock. The right to elect these directors terminates whenever dividend arrearages are brought current and/or Dynex Capital satisfies the shareholders equity test	Same as Series B	Unqualified right to elect one director as long as any shares of Series D Preferred Stock remain outstanding; right to elect two directors so long as at least 50% of the originally issued shares of Series D Preferred Stock remain outstanding
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Other Material Provisions	None	None	None	Automatic conversion of Series D shares into a new series of senior notes (subordinate to the Senior Notes) bearing an annual interest rate of 9.50% whenever Dynex Capital falls in arrears in the payment of dividends for two quarterly dividend periods or fails to maintain consolidated shareholders equity equal to at least 200% of the aggregate issue price of the then outstanding Series D Preferred
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See Proposal: Amendment of Dynex Capital's Articles of Incorporation to Accomplish Series D Conversion, Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock and the Series D Preferred Stock. Material Differences Between the

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What Will Happen to the Dividend Arrearages on my Existing Preferred Stock?

If you tender your shares of Series A Preferred Stock, Series B Preferred Stock, or Series C Preferred Stock in the Note Offer, and your tender is accepted, the dividend arrearages on the Preferred Stock you own will be eliminated, and you will not receive any accumulated dividends or arrearages on the shares accepted by Dynex Capital. Likewise, if the Series D conversion is approved, the dividend arrearages on the shares of Series A, Series B and Series C Preferred Stock remaining after the Note Offer will be eliminated, and you will not receive any accumulated dividends in arrears on the shares of Preferred Stock that are converted into Series D Preferred Stock. However, you will be entitled to any future dividends declared with respect to the Series D Preferred Stock. Those dividends will be cumulative, commencing on April 7, 2004.

For a description of the amounts of dividend arrearages on the existing shares of Preferred Stock, see Proposal: Amendment of Dynex Capital's Articles of Incorporation to Accomplish Series D Conversion - Dividend Arrearages.

How Was the Consideration Being Offered for My Shares Established?

The per share consideration that will be received by holders of Preferred Stock in the Series D conversion represents a premium over the price of each class of Preferred Stock as of January 7, 2004, the last trading day prior to our public announcement of our intention to commence the Note Offer. The per share principal amount of Senior Notes being offered in the Note Offer likewise represents a premium above the bid price of the shares of each class of Preferred Stock as of January 7, 2004. The amount of consideration being provided in the Note Offer and the Series D conversion was not based on an appraisal of Dynex Capital, but was established by the board of directors in order to make the consideration attractive to holders of Preferred Stock while at the same time providing a discount to the current liquidation value of the Preferred Stock that would benefit the holders of Common Stock, whose vote is also required to approve aspects of the recapitalization. The difference in consideration being received by holders of Preferred Stock who tender their shares in the Note Offer and holders of Preferred Stock who participate in the Series D conversion reflects the board's assessment that the reduced investment risk to recipients of Senior Notes justifies a greater amount of consideration for participants in the Series D conversion. Moreover, in establishing the Common Stock consideration to be provided in the Series D conversion, the board considered the prospect for holders of Preferred Stock to recoup the discount from the current liquidation value of their shares that will result from either the Note Offer or the Series D conversion, through possible future increases in the value of the Common Stock being received, and through future conversions of their Series D Preferred Stock into Common Stock.

What Are the Reasons for the Recapitalization?

We have been engaged in a number of recapitalization transactions since 1999, including completed tender offers for Preferred Stock in 2001 and 2003 and significant balance sheet restructuring, primarily related to the sale of assets and the repayment of recourse debt. We have decided to pursue the recapitalization at this time because of a number of factors, including:

a desire to give the holders of Preferred Stock an opportunity through the Note Offer to exchange their shares for a new series of Senior Notes and/or through the Series D conversion convert their existing shares into a new Series D Preferred Stock, both of which will be issued in a principal amount or issue price that represents a premium to the bid price of the Preferred Stock as of January 7, 2004, the last trading day before we announced the proposed recapitalization;

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a desire to enhance shareholder value by simplifying our capital structure and eliminating dividends-in-arrears on the existing Preferred Stock in anticipation of actively pursuing new strategic alternatives for Dynex Capital; and

a desire to offer the holders of Preferred Stock a new series of Preferred Stock with potentially improved liquidity, a guaranty of future representation on the board of directors and stronger covenants if we fail to pay future dividends or otherwise fall below certain financial thresholds.

See Background of the Recapitalization General and Reasons for the Series D Conversion.

What Process Did the Board Use in Deciding to Pursue the Recapitalization?

The decision to pursue the recapitalization was the result of deliberations by the board of directors and a committee of the board appointed in 2002 to consider the possibility of changes in our capital structure and other strategic alternatives. The committee held numerous meetings and considered a variety of alternatives, and recommended the recapitalization, including the Note Offer and the Series D conversion, to the full board, which unanimously approved the proposed recapitalization. See Background of the Recapitalization General and Recommendation of the Board of Directors; Fairness of the Recapitalization.

Has the Board of Directors Recommended That I Vote in Favor of the Series D Conversion?

Yes. The board of directors has unanimously approved the proposed amendment to the articles of incorporation and recommends the adoption of the proposed amendment to the stockholders of each series of the existing Preferred Stock. See Background of the Recapitalization Recommendation of the Board of Directors; Fairness of the Recapitalization.

Do the Board and the Committee Believe that the Recapitalization is Fair to Existing Stockholders?

Yes. Although the board of directors and committee did not obtain an appraisal or fairness opinion from a separate financial advisor, the board and committee believe that the Series D conversion, in conjunction with the Note Offer, is both substantively and procedurally fair to the existing holders of the Preferred Stock, including the unaffiliated stockholders of each series, because:

the holders of Preferred Stock are being given the option to tender their shares for Senior Notes that will be issued in principal amounts that represent a premium from the bid price of the Preferred Stock immediately prior to the announcement of the Note Offer, and all holders of Preferred Stock will be treated equally in the Note Offer;

the holders of Preferred Stock whose shares are converted in the Series D conversion will be treated equally within each series and among the series in the application of the conversion ratios being used to compute the number of shares of Series D Preferred Stock and Common Stock to be received by each stockholder;

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the improved conversion features of the Series D Preferred Stock will create greater opportunities for the holders of Preferred Stock to participate in any future success of Dynex Capital's business strategies by lowering the conversion price into Common Stock from \$48 or higher to \$10 per share of Common Stock;

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the holders of the new Series D Preferred Stock will be assured of continued representation on the board of directors of Dynex Capital, whereas their right to representation on the board of directors under the terms of the existing Preferred Stock depends on our failure to cure current dividend arrearages;

by combining the three series of Preferred Stock, and providing for the listing of Series D Preferred Stock on a public market, we believe that the liquidity of the Preferred Stock will be improved;

the holders of the Series D Preferred Stock will convert their shares into a senior debt instrument if Dynex Capital fails in the future to maintain current dividends or maintain its stockholders' equity above a required threshold, a right that they do not have under the terms of the existing Preferred Stock; and

the Series D conversion cannot be approved without the affirmative vote of the holders of two-thirds of each series of Preferred Stock, and the level of ownership of our directors ensures that, as a mathematical issue, at least a majority of unaffiliated holders of each series of Preferred Stock will be necessary to approve the Series D conversion in order for the Series D conversion to be approved.

See Background of the Recapitalization Recommendation of the Board of Directors; Fairness of the Recapitalization.

Did the Board of Directors and the Committee Consider Alternatives to the Note Offer and the Series D Conversion?

Yes. The board of directors and the board committee considered four principal alternatives to the Note Offer and Series D conversion:

Sale. Dynex Capital began exploring the possible sale of the company in 1999, resulting in the execution of a merger agreement in November 2000. For a number of reasons, the transaction was not completed and the merger agreement was terminated in January 2001. Since that time Dynex Capital has had various discussions with possible interested parties, but has not actively pursued a sale and has held no substantive discussions since June 2002. The board and the committee believe that our ability to pursue a sale transaction is hampered by the complexity of our capital structure and by our continued ownership of certain assets that are disfavored in the current market, including our portfolio of manufactured home loans. We also had tax net operating loss carryforwards of an estimated \$124 million as of December 31, 2003, and have not been able to find a transaction that would allow our stockholders to receive suitable consideration for that asset.

Liquidation. We have considered the possibility of liquidating the assets on our balance sheet and returning the proceeds of liquidation to our stockholders. The board and the committee have concluded that we would be unable in the near term to realize the full value of our assets, including our large loss carryforwards, through a liquidation scenario. The difficulty of conducting a successful liquidation is affected by our ownership of complex financial assets that are difficult to price, and by the fact that in a liquidation scenario we would likely be required to substantially discount assets on our balance sheet in order to find a willing buyer.

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Strategic alternatives. We have also considered the pursuit of strategic alternatives that would allow us to expand our business and more fully use the available loss carryforwards. As we have previously reported, we have explored the pursuit of a variety of strategic alternatives, including engaging a third-party manager and the possibility of acquiring a financial institution. The substantial dividend arrearages on the Preferred Stock, together with the overall complexity of our capital structure, have been impediments to the successful pursuit of a number of strategic alternatives we have considered.

No recapitalization. We have also considered the effect of electing not to restructure our Preferred Stock. Although we believe that we will generate cash flow sufficient to eliminate the dividend arrearages and/or pay future dividends, this option does not permit us to deploy as much capital to strategic alternatives and does not solve our long-term need to simplify our capital structure.

See Background of the Recapitalization General and Reasons for the Series D Conversion.

Will the Recapitalization Result in a Change of Control of Dynex Capital?

No. If the Note Offer is accepted by the minimum of 17.5% or the maximum of 70% of the holders of the existing Preferred Stock, we would issue approximately 1,078,998 or 392,221 shares, respectively, of additional Common Stock in the Series D conversion. These additional shares would represent only 9.9% or 3.6%, respectively, of the issued and outstanding shares of Common Stock. In addition, if the Note Offer is accepted by the minimum of 17.5% or the maximum of 70% of the holders of the existing Preferred Stock, we would issue approximately 4,713,288 or 1,713,304 shares of new Series D Preferred Stock, respectively. However, were Dynex Capital to waive the minimum tender requirement, and if the Note Offer is accepted by none of the holders of the existing Preferred Stock, we would issue approximately 5,713,428 shares of new Series D Preferred Stock and 1,307,957 shares of Common Stock (which would represent 12.0% of the issued and outstanding shares of Common Stock). In any event, because the holders of Preferred Stock are being treated equally in the Note Offer and Series D conversion, the holders of Series D Preferred Stock after the conversion will own Preferred Stock in proportions similar to their pre-conversion ownership of the three existing series of Preferred Stock, subject only to differences arising from individual elections to tender shares in the Note Offer and from the different conversion ratios that are based on the existing differences in the original issue price of the three series of Preferred Stock.

What Are the Federal Income Tax Consequences of the Series D Conversion?

Although the transaction should otherwise constitute a tax-free recapitalization, a stockholder whose shares of Preferred Stock are converted into shares of new Series D Preferred Stock and Common Stock will be deemed to have received a distribution with respect to the shares of Preferred Stock. A stockholder should recognize capital gain to the extent that the deemed distribution exceeds the stockholder's adjusted tax basis in the shares of Preferred Stock. A stockholder may also recognize capital gain or loss upon receipt of cash in lieu of a fractional share. With respect to each stockholder, the amount of the deemed distribution will be equal to the lesser of (i) the excess of the effective fair market values or liquidation preferences (whichever are greater) of the Series D Preferred Stock and Common Stock received or deemed to be received (in the case of fractional shares) in the transaction over the issue price of the shares surrendered in the transaction, or (ii) the amount of the dividends in arrears. Holders considering the Series D conversion should consult their tax advisors with regard to the application of the United States federal income tax laws to their particular situations as well as any tax consequences arising under the laws of any state, local or foreign taxing jurisdiction.

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See [Material Federal Income Tax Consequences](#) for a discussion of certain federal income tax consequences associated with the completion of the recapitalization and the ownership of Series D Preferred.

How Will Dynex Capital Finance the Series D Conversion?

We expect to fund the payment of fees and expenses related to the Series D conversion from available cash. The purchase of Preferred Stock that is tendered for Senior Notes will be funded by the issuance of the Senior Notes, and the conversion of existing shares of Preferred Stock not tendered and purchased will be funded through the issuance of Series D Preferred Stock and additional shares of Common Stock. In addition, to the extent we pay any cash in connection with tenders for Senior Notes or the conversion of existing shares of Preferred Stock (because the Senior Notes will be issued only in denominations of \$1,000 or integral multiples of \$1,000 and because of our desire not to issue fractional shares of Series D Preferred Stock or Common Stock), we expect to fund those cash payments from available cash.

Does the Recapitalization Involve any Conflicts of Interest?

Yes. In considering the recommendations of the board committee and the board of directors, you should be aware that four of Dynex Capital's directors, including three of the directors who served on the committee, are beneficial owners of Preferred Stock and may have interests that conflict with your interests as a holder of the Preferred Stock.

Because these directors own Preferred Stock of the three series in different proportions than the holders of Preferred Stock as a whole, and because the directors may have different tax consequences from the holders of the Preferred Stock as a whole, it is possible that the recommendations of the committee and the board of directors with respect to the Series D conversion may have been influenced by economic interests not shared by the holders of the Preferred Stock as a whole. However, the board of directors did not retain any independent or disinterested third-party to represent our unaffiliated stockholders in considering the recapitalization, including the Series D conversion.

See [Background of the Recapitalization](#), [Interests of Dynex Capital's Directors and Affiliated Parties in the Recapitalization](#) and [Security Ownership of Certain Beneficial Owners and Management](#).

Did the Board and the Committee Retain a Financial Advisor?

No. The committee and the board of directors determined that it was unnecessary to hire an outside financial advisor to evaluate the Note Offer and the Series D conversion. As described above, the committee and board of directors determined that the Note Offer and the Series D conversion were substantively fair to the holders of each series of Preferred Stock, to the holders of Dynex Capital's Common Stock, to the unaffiliated holders of each series or class of stock and to Dynex Capital as a whole. Because the fairness analysis already conducted by the committee and the board of directors reflected the fact that holders of each series of Preferred Stock will be treated equally and that the holders of Preferred Stock will be expected to receive Senior Notes, Series D Preferred Stock and Common Stock that would be listed for trading in public securities market, and because the committee and the board of directors concluded that the valuations of Dynex Capital as a going concern or for liquidation purposes would not be meaningful, the committee and board did not believe it was necessary to obtain the opinion of a separate financial advisor.

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The board of directors and the committee also concluded that the Series D conversion is procedurally fair to the unaffiliated holders of each series of the Preferred Stock. The board of directors

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and the committee took into account the fact that because of the two-thirds voting requirement, the terms of the Series D conversion would be required to be approved by a majority of disinterested holders of each series of Preferred Stock, as well as the fact that the issuance of additional shares of Common Stock in conjunction with the Series D conversion and the potential future conversion of the Series D Preferred Stock would be subject to approval by the holders of a majority of our Common Stock present and voting at the special meeting of Common Stockholders.

See Background of the Recapitalization Recommendation of the Board of Directors; Fairness of the Recapitalization and Reasons for the Series D Conversion.

Do I Have Special Rights if I Oppose the Series D Conversion?

No. The terms of each series of the existing Preferred Stock permit any term of the Preferred Stock to be amended by a vote of the holders of two-thirds of the outstanding shares of that series. If the Series D conversion is approved by the holders of two-thirds of the shares of each series of Preferred Stock, and if the Series D conversion is completed, the holders of shares of Preferred Stock who did not vote in favor of the Series D conversion will not have any dissenters', appraisal or other special rights, and will receive the same consideration in replacement of their existing shares of Preferred Stock as each other holder of the same series of Preferred Stock. See Background of the Recapitalization Recommendation of the Board of Directors; Fairness of the Recapitalization.

Will the Series D Preferred Stock be Listed for Trading on a Securities Exchange?

We intend to apply for quotation of trading prices of the Series D Preferred Stock on the Nasdaq National Market or for listing of the Series D Preferred Stock on the New York Stock Exchange. However, there is no assurance that the Series D Preferred Stock will be quoted on the Nasdaq National Market or listed on the New York Stock Exchange or that a liquid trading market will develop for the Series D Preferred Stock. If a trading market does develop, there can be no assurance as to the price at which the Series D Preferred Stock will trade.

See Effect of the Series D Conversion Series D Preferred Stock.

Will the Series D Preferred Stock Be Registered With the Securities and Exchange Commission?

No. We are relying on an exemption from the registration requirements of the Securities Act for the shares of new Series D Preferred Stock and Common Stock that will be issued as part of the Series D conversion. Under that exemption, if the shares of Preferred Stock you now hold are freely tradable, the Series D Preferred Stock and Common Stock you will receive in the Series D conversion will be freely tradable. If the shares of Preferred Stock you now hold are restricted, the Series D Preferred Stock and Common Stock you receive will be restricted to the same degree. See Effect of the Series D Conversion Exemption from Registration Requirements.

Who Will Serve as the Information Agent in Connection With the Series D Conversion?

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MacKenzie Partners, Inc. will serve as Information Agent in connection with the Series D conversion. The Information Agent's telephone number is (212) 929-5500 or (800) 322-2885 (toll free). See "Information About the Meeting - Solicitation of Proxies" and the information set forth on the back cover of this proxy statement. The Information Agent can help answer your questions.

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When is the Series D Conversion Expected to Be Completed?

Subject to the necessary stockholder approvals and satisfaction or waiver of our closing conditions, we expect the Series D conversion to be completed on the day of the meetings of the Common Stockholders and the Preferred Stockholders, or shortly after that date.

What are the Conditions to Completing the Series D Conversion?

The completion of the Series D conversion is subject to several conditions, including the following: