

A N N A L Y  
CAPITAL MANAGEMENT, INC.



2007 ANNUAL REPORT





## 2007 Annual Report



### Prodesse Non Nocere

*Our family crest and its motto  
“Prodesse Non Nocere” are  
trademarks of the Company.  
The description figuratively  
means ‘Proceed without fear.’  
That symbolizes the confidence  
we try to instill in our investors.  
It is reinforced by years of  
reliable, highly competitive  
investment performance.*

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The Brooklyn Bridge, 1900.

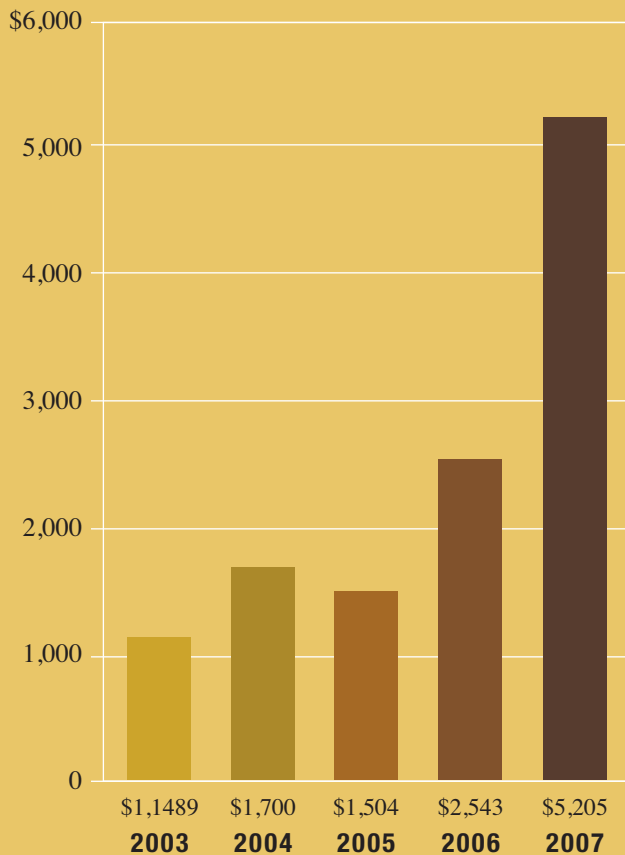


**“The cities of New York and Brooklyn have constructed, and today rejoice in the possession of, the crowning glory of an age memorable for great industrial achievements.”**

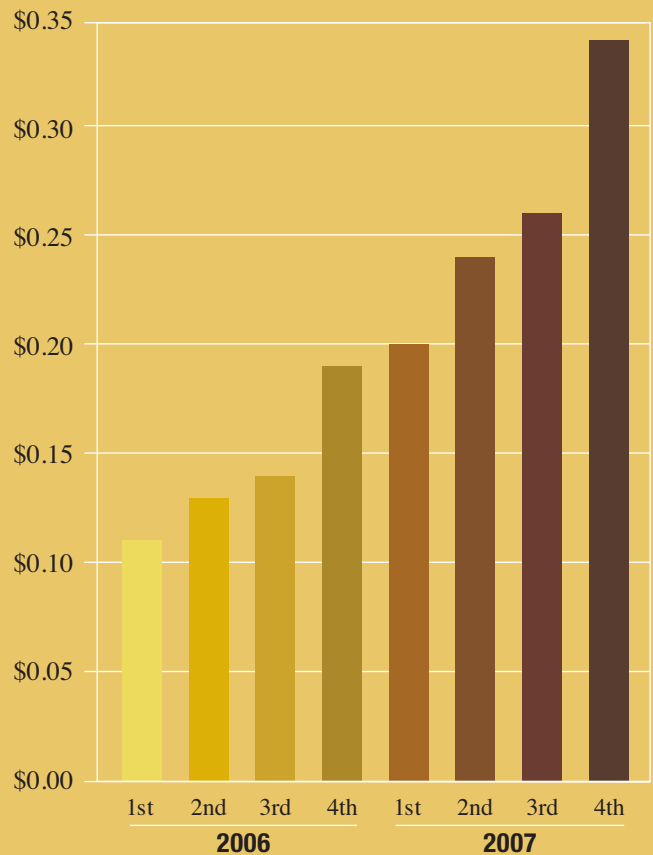
*- Abram Hewitt  
Mayor of NYC, 1887*

**D**uring 2007, Annaly executed three secondary common stock offerings, increasing shareholder equity to \$5.2 billion at the end of the year. We increased dividends each quarter over the last two years, declaring dividends to common shareholders of \$1.04 per share in 2007 versus \$0.57 in 2006, an increase of 82%. FIDAC, our wholly-owned registered investment advisor, increased net assets under management by over 19% and generated \$18 million in net fee income.

**SHAREHOLDERS' EQUITY** (dollars in millions)

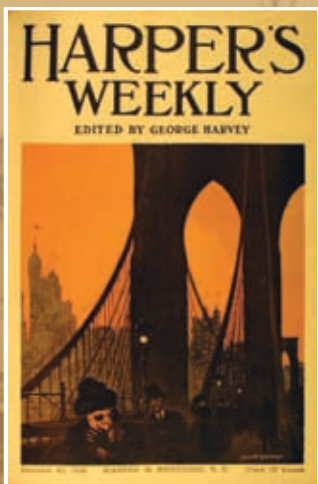


**DIVIDEND GROWTH**



“I would rather  
be the man who  
bought  
the Brooklyn Bridge  
than the man who  
sold it.”

— Will Rogers —



Chronicling American life like no other illustrated periodical of its time, Harper's Weekly covered the Brooklyn Bridge's construction in text and pictures from 1870 to 1883; its evolution into an icon of New York City.

— Brooklyn Museum

## CORPORATE PROFILE

Annaly's senior management founded FIDAC in July 1994 and Annaly in November 1996. Annaly celebrated its 10<sup>th</sup> Anniversary as a publicly traded company in 2007. Looking back from our IPO in October 1997 through 2007, the company has been resilient through turbulent markets returning over 346% to investors and raising over \$5.0 billion in additional shareholder equity.

Annaly Capital Management, Inc. manages assets on behalf of institutional and individual investors worldwide through Annaly and funds managed by its wholly-owned registered investment advisor, FIDAC. Annaly's principal business objective is to generate net income for distribution to investors from the spread between the interest income on its Mortgage-Backed Securities and the cost of borrowing to finance their acquisition and from dividends Annaly receives from FIDAC, which earns investment advisory fees. We have elected to be taxed as a real estate investment trust (or REIT) under the Internal Revenue Code and therefore are required to pay out at least 90% of our earnings to our shareholders in order to avoid taxation at the corporate level.

All of the investment securities owned by Annaly are issued and guaranteed by US Government Agencies and carry an actual or implied AAA rating. We structure our portfolio using the Annaly MBS Barbell Strategy<sup>sm</sup>. This strategy utilizes a combination of adjustable, floating, and fixed-rate Mortgage-Backed Securities so that it can perform through a wide range of interest rate environments. We employ leverage to enhance our returns. To date, our debt has consisted entirely of borrowings collateralized by a pledge of our Mortgage-Backed Securities. On our balance sheet, these borrowings appear as Repurchase Agreements. Our leverage, measured as a ratio of debt-to-equity, typically is managed in a band of 8:1 to 12:1.

The Annaly and FIDAC team is experienced in Wall Street trading, management and operations, with a specialization in investing in mortgage-backed securities on a leveraged basis. Our success and future growth prospects are based on the proven ability of our strong and seasoned management team to successfully take advantage of market opportunities and deliver compelling returns in a wide range of interest rate environments.



**Michael A. J. Farrell**  
Chairman, President  
& Chief Executive Officer



**Wellington J. Denahan-Norris**  
Vice Chairman,  
Chief Investment Officer  
& Chief Operating Officer



**Kathryn F. Fagan**  
Chief Financial Officer  
& Treasurer



**R. Nicholas Singh**  
Executive Vice President  
& General Counsel



The Great East River Suspension Bridge, Currier and Ives, c1883.

FIDAC generated over \$18 million in net fee income in 2007 and over \$74 million in net fee income since its acquisition by Annaly in 2004. The fee income generated by FIDAC adds to the spread income earned by Annaly to benefit Annaly shareholders. At December 31, 2007, FIDAC managed, advised or sub-advised approximately \$3.1 billion in net assets, an increase of 19.2% over the prior year, through numerous offshore and onshore public and private investment funds distributed globally as well as separate accounts for high net worth individuals, municipal funds and school endowments.

In 2007, FIDAC became the manager for Chimera Investment Corporation. Chimera (NYSE: CIM) raised over \$500 million in gross proceeds in its initial public stock offering in November 2007. Annaly made an investment of approximately \$54.3 million in Chimera, representing 9.8% ownership at the date of launch. Chimera is a specialty finance company that invests in residential mortgage loans, residential mortgage-backed securities, real-estate related securities and other asset classes. Chimera is organized as a REIT for federal income tax purposes.

The team managing Annaly fills the same roles at FIDAC. The general strategy for the majority of the investment products managed by FIDAC is to provide net interest income for distribution to investors from the spread between the interest income earned from the assets we purchase and the cost of financing their acquisition. Annaly shareholders benefit from the stream of dividend income received from FIDAC.



In 1883, the great American showman, P. T. Barnum, best remembered for his Ringling Bros. and Barnum & Bailey Circus, was denied the right to march Jumbo across the Brooklyn Bridge on opening day. One week later, rumor spread that the bridge was unsafe. Fear of collapse caused panic and a stampede, leaving 12 dead and 30 injured. In 1884, officials granted P.T. Barnum permission to cross the bridge with a herd of 21 elephants to demonstrate the strength of New York City's newest landmark.



Ronald D. Kazel  
Managing Director



Jeremy Diamond  
Managing Director



James P. Fortescue  
Executive Vice President,  
Head of Liabilities



Kristopher Konrad  
Executive Vice President,  
Co-Head of Portfolio Management



Rose-Marie Lyght  
Executive Vice President,  
Co-Head of Portfolio Management

## LETTER FROM THE CHAIRMAN

Dear Fellow Shareholders,

Growing up in Brooklyn gave me the unique perspective of living in an urban environment that had so many links to the rest of New York City and yet, in a very physical sense, was disconnected from it and the wider world. I learned that the connections and passageways to and from Brooklyn were as important as the place itself. Generations of Brooklynites have observed the construction of these linkages in the form of bridges, tunnels and mass transportation. As a boy, I witnessed the 20 minute ferry ride from 69<sup>th</sup> Street in Brooklyn to Staten Island turn into the graceful, sweeping presence of the Verrazano Bridge. I have vivid memories of crossing into Manhattan on the Brooklyn Bridge; from a provincial urban blend of families, pubs, synagogues and churches to the canyons of commerce on Wall Street and the possibilities beyond Brooklyn.

“Over the past four years, in our commentaries and our filings, we have outlined our growing concerns about the building pressures of the mortgage debt bubble and the risks embedded in the global financial system by poor underwriting standards.”

We are bond managers at Annaly. When we first started meeting with equity investors to raise capital in 1997, it became clear that we needed to understand their motivations as well as deepen their understanding of the fixed income markets, particularly the mortgage market. We also sought to establish Annaly as a mechanism by which these investors could understand and access the opportunities on our side of the investment universe. In many ways, over our ten-year history Annaly has become the equity investor's bridge to the largest fixed income market in the world.

Now more than ever, this role has taken on greater importance. Over the past several years, in our commentaries and our filings, we have outlined our growing concerns about the building pressures of the mortgage debt bubble and the risks embedded in the global financial system by poor underwriting standards. While Annaly has navigated its way through the creation and now destruction of this debt bubble, we have adhered to an avoidance of credit risk and continued to focus on assets issued by Ginnie Mae, Fannie Mae and Freddie Mac. These assets, wrapped with principal and interest insurance from those Government Sponsored Enterprises, are secured by the collateral of the mortgage-borrower's home, the conforming loan underwriting standards (including mortgage size limits, loan-to-value ceilings and loan documentation requirements), and the rights of foreclosure. As the forces that pierced the bubble swept across the economy in the latter half of 2007, these assets continued to perform very well during the turbulence. History will record that Annaly increased its dividend per common share by over 80% during 2007, increased its book value by nearly 9% and increased its stockholders equity over 100%.

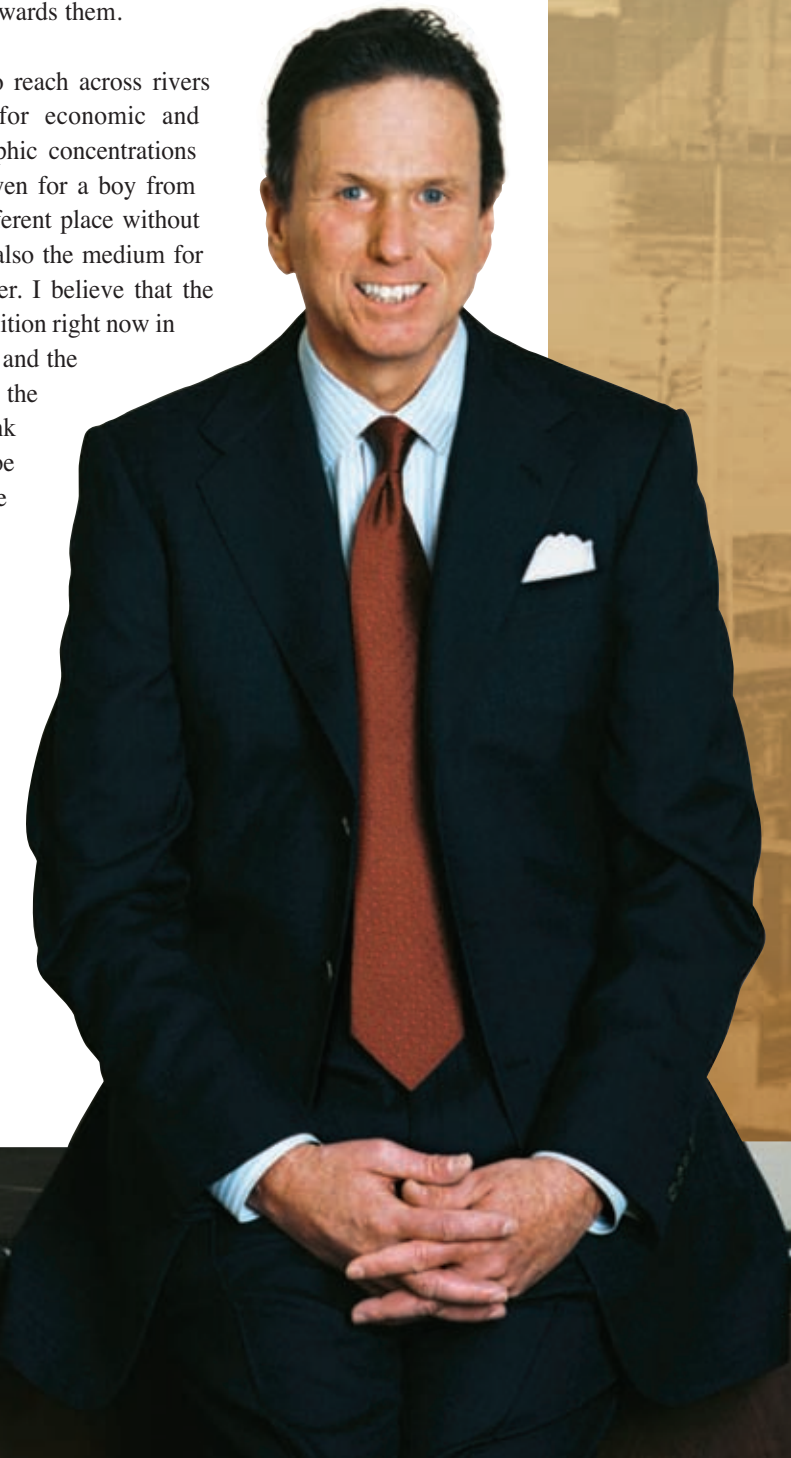
Like all asset managers, the true assets of our company travel up and down in elevators every day. In this year of such extreme market dislocation, it would be less than gracious to not recognize the people with whom I work every day. As evidenced by the numbers above, these people excelled in 2007. In light of the opportunities in front of us, decks were cleared, personal plans cancelled, long hours worked in pursuit of opportunities for the benefit of Annaly shareholders. There are literally no words to express my confidence in and gratitude towards them.

Bridges are fundamentally constructed to reach across rivers and valleys. They provide pathways for economic and community development, relieve geographic concentrations and open up new vistas and horizons, even for a boy from Brooklyn. America would be a much different place without these architectural wonders. Bridges are also the medium for transition between one terrain and another. I believe that the United States is going through such a transition right now in the financial markets, the housing market and the economy. Much of what is constructed in the financial markets acts as a metaphorical link to opportunities that investors might not be able to see or access from their side of the bridge. This is true of most investments, and it is especially true about Annaly.

*Prodesse Non Nocere*



**Michael A. J. Farrell**  
March 17, 2008



## SELECTED FINANCIAL DATA

(dollars in thousands, except for per share data)	For the Year Ended				
	December 31, 2007	December 31, 2006	December 31, 2005	December 31, 2004	December 31, 2003
<b>Statement of Operations Data:</b>					
Interest income	\$2,355,447	\$1,221,882	\$705,046	\$532,328	\$337,433
Interest expense	1,926,465	1,055,013	568,560	270,116	182,004
Net interest income	428,982	166,869	136,486	262,212	155,429
<b>Other income (loss):</b>					
Investment advisory and service fees	22,028	22,351	35,625	12,512	—
Gain (loss) on sale of investment securities	19,062	(3,862)	(53,238)	5,215	40,907
Gain on termination of interest rate swaps	2,096	10,674	—	—	—
Income from trading securities	19,147	3,994	—	—	—
Dividend income from available-for-sale equity securities	91	—	—	—	—
Loss on other-than-temporarily impaired securities	(1,189)	(52,348)	(83,098)	—	—
Total other income (loss)	61,235	(19,191)	(100,711)	17,727	40,907
<b>Expenses:</b>					
Distribution fees	3,647	3,444	8,000	2,860	—
General and administrative expenses	62,666	40,063	26,278	24,029	16,233
Total Expenses	66,313	43,507	34,278	26,889	16,233
Impairment of intangible for customer relationships	—	2,493	—	—	—
Income before income taxes	423,904	101,678	1,497	253,050	180,103
Income taxes	8,870	7,538	10,744	4,458	—
Income (loss) before minority interest	415,034	94,140	(9,247)	248,592	180,103
Minority interest	650	324	—	—	—
Net income (loss)	414,384	93,816	(9,247)	248,592	180,103
Dividends on preferred stock	21,493	19,557	14,593	7,745	—
Net income available (loss related) to common shareholders	\$392,891	\$74,259	(\$23,840)	\$240,847	\$180,103
Basic net (loss) income per average common share	\$1.32	\$0.44	(\$0.19)	\$2.04	\$1.95
Diluted net (loss) income per average common share	\$1.31	\$0.44	(\$0.19)	\$2.03	\$1.94
Dividends declared per common share	\$1.04	\$0.57	\$1.04	\$1.98	\$1.95
Dividends declared per preferred Series A share	\$1.97	\$1.97	\$1.97	\$1.45	—
Dividends declared per preferred Series B share	\$1.50	\$1.08	—	—	—
<b>Balance Sheet Data:</b>					
Mortgage-Backed Securities, at fair value	\$52,879,528	\$30,167,509	\$15,929,864	\$19,038,386	\$11,956,512
Agency Debentures, at fair value	253,915	49,500	—	390,509	978,167
Total assets	53,903,514	30,715,980	16,063,422	19,560,299	12,990,286
Repurchase agreements	46,046,560	27,514,020	13,576,301	16,707,879	11,012,903
Total liabilities	48,585,536	28,056,149	14,559,399	17,859,829	11,841,066
Stockholders' equity	5,204,938	2,543,041	1,504,023	1,700,470	1,149,220
Number of common shares outstanding	401,822,703	205,345,591	123,684,931	121,263,000	96,074,096
<b>Other Data:</b>					
Average total assets	\$41,834,831	\$23,130,057	\$18,724,075	\$17,293,174	\$12,975,039
Average investment securities	40,800,148	23,029,195	18,543,749	16,399,184	12,007,333
Average borrowings	37,967,215	21,399,130	17,408,828	15,483,118	11,549,368
Average equity	3,710,821	2,006,206	1,614,743	1,550,076	1,122,633
Yield on average interest earning assets	5.77%	5.31%	3.80%	3.25%	2.81%
Cost of funds on average interest bearing liabilities	5.07%	4.93%	3.27%	1.74%	1.58%
Interest rate spread	0.70%	0.38%	0.53%	1.51%	1.23%
<b>Financial Ratios:</b>					
Net interest margin (net interest income/average total assets)	1.03%	0.72%	0.73%	1.52%	1.20%
G&A expense as a percentage of average total assets	0.15%	0.17%	0.14%	0.14%	0.13%
G&A expense as a percentage of average equity	1.69%	2.00%	1.63%	1.55%	1.45%
Return on average total assets	0.99%	0.41%	(0.05%)	1.44%	1.39%
Return on average equity	11.17%	4.68%	(0.57%)	16.04%	16.04%



## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This annual report and our public documents to which we refer contain or incorporate by reference certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements which are based on various assumptions (some of which are beyond our control) may be identified by reference to a future period or periods or by the use of forward-looking terminology, such as “may,” “will,” “believe,” “expect,” “anticipate,” “continue,” or similar terms or variations on those terms or the negative of those terms. Actual results could differ materially from those set forth in forward-looking statements due to a variety of factors, including, but not limited to, changes in interest rates, changes in yield curve, changes in prepayment rates, the availability of mortgage-backed securities for purchase, the availability of financing and, if available, the terms of any financing, changes in the market value of our assets, changes in business conditions and the general economy, and risks associated with the investment advisory business of FIDAC, including the removal by FIDAC's clients of assets FIDAC manages, FIDAC's regulatory requirements, and competition in the investment advisory business, changes in government regulations affecting our business, and our ability to maintain our qualification as a REIT for federal income tax purposes. For a discussion of the risks and uncertainties which could cause actual results to differ from those contained in the forward-looking statements, see “Risk Factors” in our Annual Report on Form 10-K for the fiscal year ended December 31, 2007 and all subsequent Quarterly Reports on Form 10-Q. We do not undertake, and specifically disclaim any obligation, to publicly release the result of any revisions which may be made to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

### Overview

We are a REIT that owns and manages a portfolio of mortgage-backed securities. Our principal business objective is to generate net income for distribution to our stockholders from the spread between the interest income on our investment securities and the costs of borrowing to finance our acquisition of investment securities and from dividends we receive from FIDAC. FIDAC is our wholly-owned taxable REIT subsidiary, and is a registered investment advisor that generates advisory and service fee income. We acquired approximately 3.6 million shares of common stock of Chimera Investment Corporation, or Chimera, for approximately \$54.3 million in connection with Chimera's initial public offering on November 21, 2007. In addition to our investment, Chimera raised net proceeds of approximately \$479.3 million in its initial public offering. Chimera is a newly-formed, publicly traded, specialty finance company that invests in residential mortgage loans, residential mortgage-backed securities, real estate related securities and various other asset classes. Chimera is externally managed by FIDAC and intends to elect and qualify to be taxed as a REIT for federal income tax purposes. We also have a majority interest in an investment fund.

We are primarily engaged in the business of investing, on a leveraged basis, in mortgage pass-through certificates, collateralized mortgage obligations and other mortgage-backed securities representing interests in or obligations backed by pools of mortgage loans (collectively, “Mortgage-Backed Securities”). We also invest in Federal Home Loan Bank (“FHLB”), Federal Home Loan Mortgage Corporation (“FHLMC”), and Federal National Mortgage Association (“FNMA”) debentures. The Mortgage-Backed Securities and agency debentures are collectively referred to herein as “Investment Securities.”

Under our capital investment policy, at least 75% of our total assets must be comprised of high-quality mortgage-backed securities and short-term investments. High quality securities means securities that (1) are rated within one of the two highest rating categories by at least one of the nationally recognized rating agencies, (2) are unrated but are guaranteed by the United States government or an agency of the United States government, or (3) are unrated but we determine them to be of comparable quality to rated high-quality mortgage-backed securities.

The remainder of our assets, comprising not more than 25% of our total assets, may consist of other qualified REIT real estate assets which are unrated or rated less than high quality, but which are at least “investment grade” (rated “BBB” or better by Standard & Poor's Corporation (“S&P”) or the equivalent by another nationally recognized rating agency) or, if not rated, we determine them to be of comparable credit quality to an investment which is rated “BBB” or better. In addition, we may directly or indirectly invest part of this remaining 25% of our assets in other types of securities, including without limitation, unrated debt, equity or derivative securities, to the extent consistent with our REIT qualification requirements. The derivative securities in which we invest may include securities representing the right to receive interest only or a disproportionately large amount of interest, as well as inverse floaters, which may have imbedded leverage as part of their structural characteristics.

We may acquire Mortgage-Backed Securities backed by single-family residential mortgage loans as well as securities backed by loans on multi-family, commercial or other real estate related properties. To date, all of the Mortgage-Backed Securities that we have acquired have been backed by single-family residential mortgage loans.

We have elected to be taxed as a REIT for federal income tax purposes. Pursuant to the current federal tax regulations, one of the requirements of maintaining our status as a REIT is that we must distribute at least 90% of our REIT taxable income (determined without regard to the deduction for dividends paid and by excluding any net capital gain) to our stockholders, subject to certain adjustments.

The results of our operations are affected by various factors, many of which are beyond our control. Our results of operations primarily depend on, among other things, our net interest income, the market

value of our assets and the supply of and demand for such assets. Our net interest income, which reflects the amortization of purchase premiums and accretion of discounts, varies primarily as a result of changes in interest rates, borrowing costs and prepayment speeds, the behavior of which involves various risks and uncertainties. Prepayment speeds, as reflected by the Constant Prepayment Rate, or CPR, and interest rates vary according to the type of investment, conditions in financial markets, competition and other factors, none of which can be predicted with any certainty. In general, as prepayment speeds on our Mortgage-Backed Securities portfolio increase, related purchase premium amortization increases, thereby reducing the net yield on such assets. The CPR on our Mortgage-Backed Securities portfolio averaged 15% and 17% for the years ended December 31, 2007 and 2006, respectively. Since changes in interest rates may significantly affect our activities, our operating results depend, in large part, upon our ability to effectively manage interest rate risks and prepayment risks while maintaining our status as a REIT.

The current situation in the sub-prime mortgage sector, and the current weakness in the broader mortgage market, could adversely affect one or more of our lenders and could cause one or more of our lenders to be unwilling or unable to provide us with additional financing. This could potentially increase our financing costs and reduce liquidity. If one or more major market participants fails, it could negatively impact the marketability of all fixed income securities, including government mortgage securities, and this could negatively impact the value of the securities in our portfolio, thus reducing its net book value. Furthermore, if many of our lenders are unwilling or unable to provide us with additional financing, we could be forced to sell our Investment Securities at an inopportune time when prices are depressed. Even with the current situation in the sub-prime mortgage sector we do not anticipate having difficulty converting our assets to cash or extending financing term, due to the fact that our investment securities have an actual or implied “AAA” rating and principal payment is guaranteed.

The table below provides quarterly information regarding our average balances, interest income, yield on assets, average repurchase agreement balances, interest expense, cost of funds, net interest income and net interest rate spreads for the quarterly periods presented.

(ratios for the quarters have been annualized, dollars in thousands)	Average Investment Securities Held(1)	Total Interest Income	Yield on Average Investment Securities	Average Balance of Repurchase Agreements	Interest Expense	Average Cost of Funds	Net Interest Income	Net Interest Rate Spread
Quarter Ended December 31, 2007	\$49,619,857	\$720,925	5.81%	\$45,272,782	\$558,435	4.93%	\$162,490	0.88%
Quarter Ended September 30, 2007	\$43,075,489	\$628,696	5.84%	\$40,201,513	\$519,118	5.17%	\$109,578	0.67%
Quarter Ended June 30, 2007	\$38,822,274	\$556,262	5.73%	\$36,560,359	\$468,748	5.13%	\$87,514	0.60%
Quarter Ended March 31, 2007	\$31,682,974	\$449,564	5.68%	\$29,834,208	\$380,164	5.10%	\$69,400	0.58%

(1) Does not reflect unrealized gains/(losses).

The following table presents the CPR experienced on our Mortgage-Backed Securities portfolio, on an annualized basis, for the quarterly periods presented.

Quarter Ended	CPR
December 31, 2007	12%
September 30, 2007	14%
June 30, 2007	15%
March 31, 2007	17%
December 31, 2006	15%
September 30, 2006	16%
June 30, 2006	19%
March 31, 2006	18%

We believe that the CPR in future periods will depend, in part, on changes in and the level of market interest rates across the yield curve, with higher CPRs expected during periods of declining interest rates and lower CPRs expected during periods of rising interest rates.

We continue to explore alternative business strategies, alternative investments and other strategic initiatives to complement our core business strategy of investing, on a leveraged basis, in high quality Investment Securities. No assurance, however, can be provided that any such strategic initiative will or will not be implemented in the future.

For the purposes of computing ratios relating to equity measures, throughout this report, equity includes Series B preferred stock, which has been treated under GAAP as temporary equity.

### Critical Accounting Policies

Management’s discussion and analysis of financial condition and results of operations is based on the amounts reported in our financial statements. These financial statements are prepared in conformity with accounting principles generally accepted in the United States of America. In preparing the financial statements, management is required to make various judgments, estimates and assumptions that affect the reported amounts. Changes in these estimates and assumptions could have a material effect on our financial statements. The following is a summary of our policies most affected by management’s judgments, estimates and assumptions.

**Market Valuation of Investment Securities:** All assets classified as available-for-sale are reported at fair value, based on market prices. Although we generally intend to hold most of our Investment Securities until maturity, we may, from time to time, sell any of our Investment Securities as part our overall management of our portfolio. Accordingly, we are required to classify all of our Investment Securities as available-for-sale. Our policy is to obtain market values from independent sources. Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and

more frequently when economic or market concerns warrant such evaluation. The determination of whether a security is other-than-temporarily impaired involves judgments and assumptions based on subjective and objective factors. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Investments with unrealized losses are not considered other-than-temporarily impaired if the Company has the ability and intent to hold the investments for a period of time, to maturity if necessary, sufficient for a forecasted market price recovery up to or beyond the cost of the investments. Unrealized losses on Investment Securities that are considered other than temporary, as measured by the amount of decline in fair value attributable to factors other than temporary, are recognized in income and the cost basis of the Investment Securities is adjusted.

**Interest income:** Interest income is accrued based on the outstanding principal amount of the Investment Securities and their contractual terms. Premiums and discounts associated with the purchase of the Investment Securities are amortized or accreted into interest income over the projected lives of the securities using the interest method. Our policy for estimating prepayment speeds for calculating the effective yield is to evaluate historical performance, Wall Street consensus prepayment speeds, and current market conditions. If our estimate of prepayments is incorrect, we may be required to make an adjustment to the amortization or accretion of premiums and discounts that would have an impact on future income.

**Repurchase Agreements:** We finance the acquisition of our Investment Securities through the use of repurchase agreements. Repurchase agreements are treated as collateralized financing transactions and are carried at their contractual amounts, including accrued interest, as specified in the respective agreements.

**Income Taxes:** We have elected to be taxed as a REIT and intend to comply with the provisions of the Internal Revenue Code of 1986, as amended (or the Code), with respect thereto. Accordingly, the Company will not be subjected to federal income tax to the extent of its distributions to shareholders and as long as certain asset, income and stock ownership tests are met. The Company and FIDAC have made a joint election to treat FIDAC as a taxable REIT subsidiary. As such, FIDAC is taxable as a domestic C corporation and subject to federal and state and local income taxes based upon its taxable income.

**Impairment of Goodwill and Intangibles:** The Company's acquisition of FIDAC was accounted for using the purchase method. The cost of FIDAC was allocated to the assets acquired, including identifiable intangible assets, and the liabilities assumed based on their estimated fair values at the date of acquisition. The excess of cost over the fair value of the net assets acquired was recognized as goodwill. Goodwill and finite-lived intangible assets are periodically reviewed for potential impairment. This evaluation requires significant judgment.

**Recent Accounting Pronouncements-** In February 2006, the FASB issued FAS No. 155, *Accounting for Certain Hybrid Instruments* ("SFAS 155"), an amendment of FASB Statements No. 133 and 140. Among other things, SFAS 155: (i) permits fair value re-measurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation; (ii) clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS 133; (iii) establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation; (iv) clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives; and (v) amends SFAS 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. SFAS 155 was effective for all financial instruments acquired or issued by the Company after January 1, 2007. Securitized interests which only contain an embedded derivative that is tied to the prepayment risk of the underlying prepayable financial assets and for which the investor does not control the right to accelerate the settlement of such financial assets are excluded under a scope exception adopted by the FASB. None of the Company's assets were subject to SFAS 155 as a result of this scope exception. Consequently, the Company has continued to record changes in the market value of its investment securities through Other Comprehensive Income, a component of stockholders' equity. Therefore, the adoption of SFAS 155 did not have any impact on the Company's consolidated financial statements.

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109* ("FIN 48"), and related implementation issues. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in the Company's financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a threshold and measurement attribute for recognition in the financial statements of an asset or liability resulting from a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 was effective for the Company on January 1, 2007. There was no impact to the Company's financial statements from implementing this new standard.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value and requires enhanced disclosures about fair value measurements. SFAS 157 requires companies to disclose the fair value of its financial instruments according to a fair value hierarchy (i.e., levels 1, 2, and 3, as defined). Additionally, companies are required to provide enhanced disclosure regarding instruments in the level 3 category (the valuation of which require significant management judgment), including a reconciliation of the beginning and ending balances separately for each major category of assets and liabilities. SFAS 157 is effective for the Company

on January 1, 2008. The Company does not believe that the adoption of SFAS 157 will have a significant impact on its financial position or results of operations or the manner in which it estimates fair value, but expects that adoption will increase footnote disclosure to comply with SFAS 157 disclosure requirements for financial statements issued after January 1, 2008.

In February 2007, the FASB issued SFAS No 159, *The Fair Value Option for Financial Assets and Financial Liabilities* – including an amendment of FASB Statement No. 115 (“SFAS 159”). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected will be recognized in earnings at each subsequent reporting date SFAS 159 is effective for the Company commencing January 1, 2008. The Company is not expecting SFAS 159 to have an effect on the consolidated financial statements. The Company did not elect the fair value option for any existing eligible financial instruments.

**Proposed FASB Staff Position** - The FASB issued a proposed FASB Staff Position (“FSP”) FAS No. 140-d relating to FASB Statement No. 140, *Accounting for Transfers of Financial Assets and Repurchase Financing Transactions* to address situations where assets purchased from a particular counterparty and financed through a repurchase agreement with the same counterparty can be considered and accounted for as separate transactions. Currently, the Company records such assets and the related financing on a gross basis in the consolidated statement of financial condition, and the corresponding interest income and interest expense in the Company’s consolidated statement of operations and comprehensive income (loss). For assets representing available-for-sale investment securities, as in the Company’s case, any change in fair value is reported through other comprehensive income under SFAS 115, with the exception of impairment losses, which are recorded in the consolidated statement of operations and comprehensive (loss) income as realized losses.

FASB’s proposed staff position requires that all of the following criteria be met in order to continue the application of SFAS 140 as described above: (1) the initial transfer of and repurchase financing cannot be contractually contingent; (2) the repurchase financing entered into between the parties provides full recourse to the transferee and the repurchase price is fixed; (3) the financial asset is “readily obtainable” in the marketplace and the transfer is executed at market rates; (4) the borrower maintains the right to the collateral and the lender cannot re-pledge the asset prior to settlement of the repurchase agreement; and (4) the repurchase agreement and financial asset do not mature simultaneously.

At this time, the Company believes that its purchases and subsequent financing through repurchase agreements with the same counterparty meet the criteria enumerated in the proposed FSP FAS No. 140-d for treatment as a non-linked transfer and repurchase under SFAS 140 and the Company believes that if the FSP is ultimately issued in substantially its current form, there will be no effect on the manner in which the Company records such assets, their financings, and the corresponding interest income and interest expense. FSP FAS 140-d

may be subject to significant changes prior to finalization, which may impact the Company’s current assessment of its impact.

## RESULTS OF OPERATIONS

### Net Income Summary

For the year ended December 31, 2007, our net income was \$414.4 million or \$1.32 basic income per average share related to common shareholders, as compared to \$93.8 million net income or \$0.44 basic net income per average share for the year ended December 31, 2006. For the year ended December 31, 2005, our net loss was \$9.2 million or \$0.19 basic loss per average share related to common shareholders. Net income per average share increased by \$0.88 per average share available to common shareholders and total net income increased \$320.6 million for the year ended December 31, 2007, when compared to the year ended December 31, 2006. We attribute the increase in total net income for the year ended December 31, 2007 from the year ended December 31, 2006 to an increase in net interest income, gains on the sale of securities, a reduction in losses on other-than-temporarily impaired securities, the increased asset base, and the increase in interest rate spread. Net interest income increased by \$262.1 million for the year ended December 31, 2007, as compared to the year ended December 31, 2006, due to the increase in interest earning assets from the deployment of additional capital we raised in 2007 and the improved interest rate spread. For the year ended December 31, 2007, net gain on sale of Mortgage-Backed Securities was \$19.1 million, as compared to a net loss of \$3.9 million for the year ended December 31, 2006. The loss on other-than-temporarily impaired securities totaled \$1.2 million for the year ended December 31, 2007, as compared to \$52.3 million for the year ended December 31, 2006. During the year ended December 31, 2007, the Company realized a gain on the termination of interest rate swaps of \$2.1 million, as compared to a \$10.7 million gain for the year ended December 31, 2006.

We attribute the increase in total net income for the year ended December 31, 2006 compared to the year ended December 31, 2005 to the increase in net interest income, reduction in losses on sales of securities and losses on other-than-temporarily impaired securities, and gains on termination of interest rate swaps. The interest rate spread decreased from 0.53% for the year ended December 31, 2005 to 0.38% for the year ended December 31, 2006. The total amortization for the year ended December 31, 2006 was \$63.6 million and for the year ended December 31, 2005 was \$154.3 million. This decline in amortization increased the yield on interest earning assets. The increased yield was more than offset by the increase funding cost, resulting in a net decline in interest rate spread. For the year ended December 31, 2006, net loss on sale of Mortgage-Backed Securities was \$3.9 million, as compared to a net loss of \$53.2 million in 2005.

The table below presents the net income (loss) summary for the years ended December 31, 2007, 2006, and 2005.

### Net Income (Loss) Summary

(dollars in thousands, except for per share data)	December 31, 2007	For the Year Ended December 31, 2006	December 31, 2005
Interest income	\$2,355,447	\$1,221,882	\$705,046
Interest expense	1,926,465	1,055,013	568,560
Net interest income	428,982	166,869	136,486
Other income (loss):			
Investment advisory and service fees	22,028	22,351	35,625
Gain (loss) on sale of investment securities	19,062	(3,862)	(53,238)
Gain on termination of interest rate swaps	2,096	10,674	—
Income from trading securities	19,147	3,994	—
Dividend income from available-for-sale equity securities	91		
Loss on other-than-temporarily impaired securities	(1,189)	(52,348)	(83,098)
Total other income (loss)	61,235	(19,191)	(100,711)
Expenses			
Distribution fees	3,647	3,444	8,000
General and administrative expenses	62,666	40,063	26,278
Total expenses	66,313	43,507	34,278
Impairment of intangible for customer relationships	—	2,493	—
Income before income taxes and minority interest	423,904	101,678	1,497
Income taxes	8,870	7,538	10,744
Income (loss) before minority interest	415,034	94,140	(9,247)
Minority interest	650	324	—
Net Income (loss)	414,384	93,816	(9,247)
Dividends on preferred stock	21,493	19,557	14,593
Net income available (loss related) to common shareholders	\$392,891	\$74,259	(\$23,840)
Weighted average number of basic common shares outstanding	297,488,394	167,666,631	122,475,032
Weighted average number of diluted common shares outstanding	306,263,766	167,746,387	122,475,032
Basic net income (loss) per average common share	\$1.32	\$0.44	(\$0.19)
Diluted net income (loss) per average common share	\$1.31	\$0.44	(\$0.19)
Average total assets	\$41,834,831	\$23,130,057	\$18,724,075
Average equity	3,710,821	2,006,206	1,614,743
Return on average total assets	0.99%	0.41%	(0.05%)
Return on average equity	11.17%	4.68%	(0.57%)

### Interest Income and Average Earning Asset Yield

We had average earning assets of \$40.8 billion for the year ended December 31, 2007. We had average earning assets of \$23.0 billion for the year ended December 31, 2006. We had average earning assets of \$18.5 billion for the year ended December 31, 2005. Our primary source of income is interest income. Our interest income was \$2.4 billion for the year ended December 31, 2007, \$1.2 billion for the year ended December 31, 2006, and \$705.0 million for the year ended December 31, 2005. The yield on average investment securities was 5.77%, 5.31%, and 3.80% for the respective periods. The prepayment speeds decreased to an average of 15% CPR for the year ended December 31, 2007 from an average of 17% CPR for the year ended December 31, 2006. The increase in coupon rates and reduction in prepayment speeds resulted in an increase in yield.

### Interest Expense and the Cost of Funds

Our largest expense is the cost of borrowed funds. We had average borrowed funds of \$38.0 billion and total interest expense of \$1.9 billion for the year ended December 31, 2007. We had average borrowed funds of \$21.4 billion and total interest expense of \$1.1 billion for the year ended December 31, 2006. We had average borrowed funds of \$17.4 billion and total interest expense of \$568.6 million for the year ended December 31, 2005. Our average cost of funds was 5.07% for the year ended December 31, 2007 and 4.93% for the year ended December 31, 2006 and 3.27% for the year ended December 31, 2005. The cost of funds rate increased by 14 basis points and the average borrowed funds increased by \$16.6 billion for the year ended December 31, 2007 when compared to the year ended December 31, 2006. Interest expense for the year 2007

increased by \$871.5 million over the prior year due to the substantial increase in the average borrowed funds and the increase in the average cost of funds rate. The cost of funds rate increased by 166 basis points and the average borrowed funds increased by \$4.0 billion for the year ended December 31, 2006 when compared to the year ended December 31, 2005. Interest expense for the year ended December 31, 2006 increased by \$486.5 million over the previous year due to the increase in the average borrowed funds. Since a substantial portion of our repurchase agreements are short term, changes

in market rates are directly reflected in our interest expense. Our average cost of funds was 0.12% below average one-month LIBOR and 0.12% below average six-month LIBOR for the year ended December 31, 2007. Our average cost of funds was 0.10% below average one-month LIBOR and 0.28% below average six-month LIBOR for the year ended December 31, 2006. Our average cost of funds was 0.06% below average one-month LIBOR and 0.45% below average six-month LIBOR for the year ended December 31, 2005.

The table below shows our average borrowed funds and average cost of funds as compared to average one-month and average six-month LIBOR for the years ended December 31, 2007, 2006, 2005, 2004, and 2003 and the four quarters in 2007.

### Average Cost of Funds

(Ratios for the four quarters in 2007 have been annualized, dollars in thousands)	Average Borrowed Funds	Interest Expense	Average Cost of Funds	Average One-Month LIBOR	Average Six-Month LIBOR	Average One-Month LIBOR Relative to Average Six-Month LIBOR	Average of Funds Relative to Average One-Month LIBOR	Average Cost of Funds Relative to Average Six-Month LIBOR
For the Year Ended December 31, 2007	\$37,967,215	\$1,926,465	5.07%	5.19%	5.19%	(0.00%)	(0.12%)	(0.12%)
For the Year Ended December 31, 2006	\$21,399,130	\$1,055,013	4.93%	5.03%	5.21%	(0.18%)	(0.10%)	(0.28%)
For the Year Ended December 31, 2005	\$17,408,828	\$568,560	3.27%	3.33%	3.72%	(0.39%)	(0.06%)	(0.45%)
For the Year Ended December 31, 2004	\$15,483,118	\$270,116	1.74%	1.50%	1.80%	(0.30%)	0.24%	(0.06%)
For the Year Ended December 31, 2003	\$11,549,368	\$182,004	1.58%	1.21%	1.23%	(0.02%)	0.37%	0.35%
For the Quarter Ended December 31, 2007	\$45,272,782	\$558,435	4.93%	4.86%	4.85%	0.01%	0.07%	0.08%
For the Quarter Ended September 30, 2007	\$40,201,513	\$519,118	5.17%	5.37%	5.31%	0.07%	(0.20%)	(0.14%)
For the Quarter Ended June 30, 2007	\$36,560,359	\$468,748	5.13%	5.32%	5.37%	(0.05%)	(0.19%)	(0.24%)
For the Quarter Ended March 31, 2007	\$29,834,208	\$380,164	5.10%	5.26%	5.30%	(0.04%)	(0.16%)	(0.20%)

### Net Interest Income

Our net interest income, which equals interest income less interest expense, totaled \$429.0 million for the year ended December 31, 2007, \$166.9 million for the year ended December 31, 2006 and \$136.5 million for the year ended December 31, 2005. Our net interest income increased for the year ended December 31, 2007, as compared to the year ended December 31, 2006, because of the increased average asset base in 2007 and the increased interest rate spread. In 2007 average assets increased because of the deployment of additional capital. Our net interest spread, which equals the yield on our average assets for the period less the average cost of funds for

the period, was 0.70% for the year ended December 31, 2007 as compared to 0.38% for the year ended December 31, 2006 and 0.53% for the year ended December 31, 2005. This 32 basis point increase in interest rate spread for 2007 over the spread for 2006 was the result in the increased yield of 46 basis points, partially offset by an increase of in the average cost of funds of 14 basis points.

Our net interest income increased for the year ended December 31, 2006 as compared to the year ended December 31, 2005 by \$30.4 million because of the increased average asset base for 2006.

The table below shows our interest income by average Investment Securities held, total interest income, yield on average interest earning assets, average balance of repurchase agreements, interest expense, average cost of funds, net interest income, and net interest rate spread for the years ended December 31, 2007, 2006, 2005, 2004, and 2003 and the four quarters in 2007.

### Net Interest Income

(Ratios for the four quarters in 2007 have been annualized, dollars in thousands)	Average Investment Securities Held	Total Interest Income	Yield on Average Interest Earning Assets	Average Balance of Repurchase Agreements	Interest Expense	Average Cost of Funds	Net Interest Income	Net Interest Rate Spread
For the Year Ended December 31, 2007	\$40,800,148	\$2,355,447	5.77%	\$37,967,215	\$1,926,465	5.07%	\$428,982	0.70%
For the Year Ended December 31, 2006	\$23,029,195	\$1,221,882	5.31%	\$21,399,130	\$1,055,013	4.93%	\$166,869	0.38%
For the Year Ended December 31, 2005	\$18,543,749	\$705,046	3.80%	\$17,408,827	\$568,560	3.27%	\$136,486	0.53%
For the Year Ended December 31, 2004	\$16,399,184	\$532,328	3.25%	\$15,483,118	\$270,116	1.74%	\$262,212	1.51%
For the Year Ended December 31, 2003	\$12,007,333	\$337,433	2.81%	\$11,549,368	\$182,004	1.58%	\$155,429	1.23%
For the Quarter Ended December 31, 2007	\$49,619,857	\$720,925	5.81%	\$45,272,782	\$558,435	4.93%	\$162,490	0.88%
For the Quarter Ended September 30, 2007	\$43,075,489	\$628,696	5.84%	\$40,201,513	\$519,118	5.17%	\$109,578	0.67%
For the Quarter Ended June 30, 2007	\$38,822,274	\$556,262	5.73%	\$36,560,359	\$468,748	5.13%	\$87,514	0.60%
For the Quarter Ended March 31, 2007	\$31,682,974	\$449,564	5.68%	\$29,834,208	\$380,164	5.10%	\$69,400	0.58%

### Investment Advisory and Service Fees

FIDAC is a registered investment advisor which specializes in managing fixed income securities. FIDAC expanded its business in 2007 to manage Chimera Investment Corporation, a newly-formed specialty finance company that invests in residential mortgage loans, residential mortgage-backed securities, real estate related securities and various other asset classes. In 2006 FIDAC expanded its business to include the management of equity securities, initially for us and an affiliated person and collateralized debt obligations. FIDAC generally receives annual net investment advisory fees on the assets it manages, assists in managing or supervises. At December 31, 2007, FIDAC had under management approximately \$3.1 billion in net assets and \$15.4 billion in gross assets, compared to \$2.6 billion in net assets and \$15.1 billion in gross assets at December 31, 2006. Net investment advisory and service fees for the years ended December 31, 2007, 2006, and 2005 totaled \$18.4 million, \$18.9 million, and \$27.6 million, respectively, net of fees paid to third parties pursuant to distribution service agreements for facilitating and promoting distribution of shares or units to FIDAC's clients. Gross assets under management will vary from time to time because of changes in the amount of net assets FIDAC manages as well as changes in the amount of leverage used by the various funds and accounts FIDAC manages.

### Gains and Losses on Sales of Investment Securities and Interest Rate Swaps

For the year ended December 31, 2007, we sold Investment Securities with a carrying value of \$4.9 billion for an aggregate gain of \$19.1 million. In addition, we had a \$2.1 million gain on the termination of interest rate swaps with a notional value of \$900 million. For the year ended December 31, 2006, we sold investment securities with an aggregate historical amortized value of \$3.2 billion for an aggregate loss of \$3.9 million. In addition, the Company had a \$10.7 million gain on the termination of interest rate swaps with a notional value of \$1.2 billion. For the year ended December 31, 2005, we sold investment securities with an aggregate historical amortized value of \$3.4 billion for an aggregate loss of \$53.2 million. The loss on sale of assets for the year ended December 31, 2005 was due to portfolio rebalancing that was initiated in the fourth quarter of 2005. We determined that certain assets purchased in a much lower interest rate environment of 2003 and 2004 were unlikely to receive their amortized cost basis, and commenced selling these assets. The rebalancing was done with the objective of improving future financial performance. A positive difference between the sale price and the historical amortized cost of our Mortgage-Backed Securities is a realized gain and increases income accordingly. We do not expect to sell assets on a frequent basis, but may from time to time sell existing assets to move into new assets, which our management believes might have higher risk-adjusted returns, or to manage our balance sheet as part of our asset/liability management strategy.

### Income from Trading Securities

Gross income from trading securities totaled \$19.1 million for the year ended December 31, 2007 and \$4.0 million for the year ended December 31, 2006.

### Dividend Income from Available-For-Sale Equity Securities

Dividend income from available-for-sale equity securities total \$91,000 for the year ended December 31, 2007. For the years ended December 31, 2006 and 2005, we did not have an investment in available-for-sale equity securities.

### Loss on Other-Than-Temporarily Impaired Securities

At each quarter end, we review each of our securities to determine if an other-than-temporary impairment charge would be necessary. We will take these charges if we determine that we do not intend to hold securities that were in an unrealized loss position for a period of time, to maturity if necessary, sufficient for a forecasted market price recovery up to or beyond the cost of the investments. For the year ended December 31, 2007 the loss on other-than-temporarily impaired securities totaled \$1.2 million. For the years ended December 31, 2006 and 2005, the loss on other-than-temporarily impaired securities totaled \$52.3 million and \$83.1 million, respectively.

### Impairment of Goodwill and Intangibles

During the year ended December 31, 2007, it was determined that there was no impairment of intangibles. The total impairment of intangible assets relating to customer relationships was \$2.5 million for the year ended December 31, 2006. There was no impairment charges during the year ended December 31, 2005. There were no impairment charges related to goodwill during the years ended 2007, 2006, and 2005.

### General and Administrative Expenses

General and administrative (or G&A) expenses were \$62.7 million for the year ended December 31, 2007, \$40.1 million for the year ended December 31, 2006, and \$26.3 million for the year ended December 31, 2005. General and administrative expenses as a percentage of average total assets was 0.15%, 0.17%, and 0.14% for the years ended December 31, 2007, 2006, and 2005, respectively. The increase in G&A expenses of \$22.6 million for the year December 31, 2007 was primarily the result of increased salaries, directors and officers insurance and additional costs related to FIDAC. Staff increased from 31 at the end of 2005 to 34 at the end of 2006 and 39 at the end of 2007. Salaries and bonuses for the years ended December 31, 2007, 2006, and 2005 were \$48.1 million, \$28.7 million and \$18.8 million, respectively.

The table below shows our total G&A expenses as compared to average total assets and average equity for the years ended December 31, 2007, 2006, 2005, 2004, and 2003 and the four quarters in 2007.

### G&A Expenses and Operating Expense Ratios

(Ratios for the quarters have been annualized, dollars in thousands)	Total G&A Expenses	Total G&A Expenses/Average Assets	Total G&A Expenses/Average Equity
For the Year Ended December 31, 2007	\$62,666	0.15%	1.69%
For the Year Ended December 31, 2006	\$40,063	0.17%	2.00%
For the Year Ended December 31, 2005	\$26,278	0.14%	1.63%
For the Year Ended December 31, 2004	\$24,029	0.14%	1.55%
For the Year Ended December 31, 2003	\$16,233	0.13%	1.45%
For the Quarter Ended December 31, 2007	\$20,174	0.16%	1.72%
For the Quarter Ended September 30, 2007	\$17,334	0.16%	1.94%
For the Quarter Ended June 30, 2007	\$12,272	0.12%	1.50%
For the Quarter Ended March 31, 2007	\$12,886	0.15%	1.70%

### Net Income and Return on Average Equity

Our net income was \$414.4 million for the year ended December 31, 2007, net income was \$93.8 million for the year ended December 31, 2006, and our net loss was \$9.2 million for the year ended December 31, 2005. Our return on average equity was 11.17% for the year ended December 31, 2007, was 4.68% for the year ended December 31, 2006, and (0.57%) for the year ended December 31, 2005. Even

with the increase in G&A expenses, net income for the year increased by \$320.6 million. We attribute the increase in total net income for the year ended December 31, 2007 over the year ended December 31, 2006 to the increase in net interest income, the gains realized on sale of assets and the decrease in loss on other-than-temporarily impaired securities, income realized from trading securities, and the gains realized on the termination of interest rate swaps.

The table below shows our net interest income, net investment advisory and service fees, gain (loss) on sale of Mortgage-Backed Securities and termination of interest rate swaps, loss on other-than-temporarily impaired securities, income from equity investment, dividend income from available-for-sale equity securities, G&A expenses, income taxes, impairment of intangibles for customer relationships, minority interest, each as a percentage of average equity, and the return on average equity for the years ended December 31, 2007, 2006, 2005, 2004, and 2003, and the four quarters in 2007.

### Components of Return on Average Equity

(Ratios for the quarters have been annualized)	Net Interest Income/Average Equity	Net Investment Advisory and Service Fees/Average Equity	Gain/(Loss) on Sale of Mortgage-Backed Securities and Interest Rate Swaps/Average Equity	Loss on other-than-temporarily Impaired Securities/Average Equity	Income from Equity Investment/Average Equity	Dividend Income from Available-for-sale Equity Securities	G&A Expenses/Average Equity	Income Taxes/Average Equity	Impairment of Intangible for Customer Relationships /Average Equity	Minority Interest/Average Equity	Return on Average Equity
For the Year Ended											
December 31, 2007	11.56%	0.50%	0.57%	(0.03%)	0.52%	0.00%	(1.69%)	(0.24%)	—	(0.02%)	11.17%
December 31, 2006	8.32%	0.94%	0.34%	(2.61%)	0.20%	—	(2.00%)	(0.38%)	(0.12%)	(0.01%)	4.68%
December 31, 2005	8.45%	1.71%	(3.30%)	(5.15%)	—	—	1.63%	0.67%	—	—	(0.57%)
December 31, 2004	16.92%	0.62%	0.34%	—	—	—	1.55%	0.29%	—	—	16.04%
December 31, 2003	13.85%	—	3.64%	—	—	—	1.45%	—	—	—	16.04%
For the Quarter Ended											
December 31, 2007	13.89%	0.41%	0.16%	—	0.61%	0.00%	(1.72%)	(0.26%)	—	(0.02%)	13.07%
September 30, 2007	12.23%	0.49%	0.65%	—	0.93%	—	(1.94%)	(0.26%)	—	(0.01%)	12.09%
June 30, 2007	10.71%	0.55%	0.89%	(0.09%)	0.03%	—	(1.50%)	(0.10%)	—	—	10.49%
March 31, 2007	9.14%	0.61%	0.82%	(0.06%)	0.45%	—	(1.70%)	(0.34%)	—	(0.04%)	8.88%



## FINANCIAL CONDITION

### Investment Securities, Available for Sale

All of our Mortgage-Backed Securities at December 31, 2007, 2006, and 2005 were adjustable-rate or fixed-rate mortgage-backed securities backed by single-family mortgage loans. All of the mortgage assets underlying these mortgage-backed securities were secured with a first lien position on the underlying single-family properties. All of our mortgage-backed securities were FHLMC, FNMA or GNMA mortgage pass-through certificates or CMOs, which carry an actual or implied “AAA” rating. All of our agency debentures are callable and carry a “AAA” rating. We carry all of our earning assets at fair value.

We accrete discount balances as an increase in interest income over the life of discount investment securities and we amortize premium balances as a decrease in interest income over the life of premium investment securities. At December 31, 2007, 2006, and 2005 we had on our balance sheet a total of \$77.4 million, \$78.4 million and \$21.5 million, respectively, of unamortized discount (which is the difference between the remaining principal value and current historical amortized cost of our investment securities acquired at a price below principal value) and a total of \$405.8 million, \$219.1 million and

\$242.1 million, respectively, of unamortized premium (which is the difference between the remaining principal value and the current historical amortized cost of our investment securities acquired at a price above principal value).

We received mortgage principal repayments of \$6.8 billion for the year ended December 31, 2007, \$5.1 billion for the year ended December 31, 2006, and \$7.1 billion for the year ended December 31, 2005. The average prepayment speed for the year ended December 31, 2007, 2006 and 2005 was 15%, 17%, and 27%, respectively. During the year ended December 31, 2007, the average CPR declined to 15% from 17% during the year ended December 31, 2006, due to a decline in refinancing activity. Given our current portfolio composition, if mortgage principal prepayment rates were to increase over the life of our mortgage-backed securities, all other factors being equal, our net interest income would decrease during the life of these mortgage-backed securities as we would be required to amortize our net premium balance into income over a shorter time period. Similarly, if mortgage principal prepayment rates were to decrease over the life of our mortgage-backed securities, all other factors being equal, our net interest income would increase during the life of these mortgage-backed securities as we would amortize our net premium balance over a longer time period.

The table below summarizes certain characteristics of our Investment Securities at December 31, 2007, 2006, 2005, 2004, and 2003 and September 30, 2007, June 30, 2007, and March 31, 2007.

### Investment Securities

(dollars in thousands)	Principal Amount	Net Premium	Amortized Cost	Amortized Cost/Principal Amount	Fair Value	Fair Value/Principal Amount	Weighted Average Yield
At December 31, 2007	\$52,569,598	\$328,376	\$52,897,974	100.62%	\$53,133,443	101.07%	5.75%
At December 31, 2006	\$30,134,791	\$140,709	\$30,275,500	100.47%	\$30,217,009	100.27%	5.63%
At December 31, 2005	\$15,915,801	\$220,637	\$16,136,438	101.39%	\$15,929,864	100.09%	4.68%
At December 31, 2004	\$19,123,902	\$425,792	\$19,549,694	102.23%	\$19,428,895	101.59%	3.43%
At December 31, 2003	\$12,682,130	\$299,810	\$12,981,940	102.36%	\$12,934,679	101.99%	2.96%
At September 30, 2007	\$44,904,820	\$229,713	\$45,134,533	100.51%	\$44,890,633	99.97%	5.74%
At June 30, 2007	\$39,102,277	\$211,438	\$39,313,715	100.54%	\$38,753,509	99.11%	5.71%
At March 31, 2007	\$39,053,196	\$195,649	\$39,248,845	100.50%	\$39,230,648	100.45%	5.67%

The table below summarizes certain characteristics of our Investment Securities at December 31, 2007, 2006, 2005, 2004, and 2003 and September 30, 2007, June 30, 2007, and March 31, 2007. The index level for adjustable-rate Investment Securities is the weighted average rate of the various short-term interest rate indices, which determine the coupon rate.

### Adjustable-Rate Investment Security Characteristics

(dollars in thousands)	Principal Amount	Weighted Average Coupon Rate	Weighted Average Term to Next Adjustment	Weighted Average Lifetime Cap	Weighted Average Asset Yield	Principal Amount at Period End as % of Total Investments Securities
At December 31, 2007	\$15,331,447	5.90%	39 months	9.89%	5.63%	29.16%
At December 31, 2006	\$8,493,242	5.72%	19 months	9.76%	5.57%	28.18%
At December 31, 2005	\$9,699,133	4.76%	22 months	10.26%	4.74%	60.94%
At December 31, 2004	\$13,544,872	4.23%	24 months	10.12%	3.24%	70.83%
At December 31, 2003	\$9,294,934	3.85%	23 months	9.86%	2.47%	73.29%
At September 30, 2007	\$13,148,355	5.99%	41 months	10.02%	5.68%	29.28%
At June 30, 2007	\$9,553,827	5.85%	32 months	10.11%	5.77%	24.43%
At March 31, 2007	\$9,657,221	5.79%	30 months	10.05%	5.66%	24.73%

## Fixed-Rate Investment Security Characteristics

(dollars in thousands)	Principal Amount	Weighted Average Coupon Rate	Weighted Average Asset Yield	Principal Amount at Period End as % of Total Investment Securities
At December 31, 2007	\$37,238,151	6.00%	5.80%	70.84%
At December 31, 2006	\$21,641,549	5.83%	5.65%	71.82%
At December 31, 2005	\$6,216,668	5.37%	4.60%	39.06%
At December 31, 2004	\$5,579,030	5.24%	3.89%	29.17%
At December 31, 2003	\$3,387,196	5.77%	4.29%	26.71%
At December 31, 2002	\$4,195,322	6.76%	4.78%	37.45%
At September 30, 2007	\$31,756,465	5.93%	5.76%	70.72%
At June 30, 2007	\$29,548,450	5.87%	5.69%	75.57%
At March 31, 2007	\$29,395,975	5.85%	5.67%	75.27%

At December 31, 2007 and 2006, we held Investment Securities with coupons linked to various indices. The following tables detail the portfolio characteristics by index.

## Adjustable-Rate Investment Securities by Index

December 31, 2007	One-Month LIBOR	Six-Month LIBOR	Twelve-Month LIBOR	Twelve-Month Moving Average	11 <sup>th</sup> District Cost of Funds	1-Year Treasury Index	3-Year Treasury Index	Monthly Federal Cost of Funds	One-Month LIBOR-USD	Twelve-Month LIBOR-USD	Other Indexes <sup>(1)</sup>
Weighted Average Term to Next Adjustment	1 mo.	38 mo.	72 mo.	1 mo.	1 mo.	36 mo.	18 mo.	1 mo.	1 mo.	60 mo.	10 mo.
Weighted Average Annual Period Cap	6.48%	1.72%	2.00%	.42%	0.00%	1.88%	2.07%	0.00%	2.00%	2.00%	1.84%
Weighted Average Lifetime Cap at December 31, 2007	7.13%	11.25%	11.08%	9.15%	12.08%	10.73%	13.18%	13.43%	12.8%	10.94%	10.73%
Investment Principal Value as Percentage of Investment Securities at December 31, 2007	8.24%	1.89%	7.23%	0.67%	0.19%	3.39%	0.05%	0.13%	0.19%	7.14%	0.04%

(1) Combination of indexes that account for less than 0.05% of total investment securities.

## Adjustable-Rate Investment Securities by Index

December 31, 2006	One-Month LIBOR	Six-Month LIBOR	Twelve-Month LIBOR	Twelve-Month Moving Average	11 <sup>th</sup> District Cost of Funds	Six-Month CD Rate	1-Year Treasury Index	3-Year Treasury Index	Monthly Federal Cost of Funds	Other Indexes <sup>(1)</sup>
Weighted Average Term to Next Adjustment	1 mo.	35 mo.	36 mo.	1 mo.	1 mo.	3 mo.	13 mo.	17 mo.	1 mo.	24 mo.
Weighted Average Annual Period Cap	6.70%	1.88%	2.00%	0.16%	0.00%	1.75%	1.00%	2.03%	0.00%	1.89%
Weighted Average Lifetime Cap at December 31, 2006	7.32%	10.39%	10.70%	10.53%	12.07%	9.75%	10.81%	13.17%	13.41%	12.39%
Investment Principal Value as Percentage of Investment Securities at December 31, 2006	8.29%	2.71%	9.89%	0.07%	0.41%	0.06%	6.34%	0.10%	0.28%	0.03%

(1) Combination of indexes that account for less than 0.05% of total investment securities.

### Trading Securities and Trading Securities Sold, Not Yet Purchased

Trading securities and trading securities sold, not yet purchased, are included in the balance sheet as a result of consolidating the financial statements of an affiliated investment fund. The resulting realized and unrealized gains and losses are reflected in the statements of operations. The fair value of the trading securities was \$11.7 million and the trading securities sold, not yet purchased, was \$32.8 million at December 31, 2007. The fair value of the trading securities was \$18.4 million and the trading securities sold, not yet purchased, was \$41.9 million at December 31, 2006.

### Borrowings

To date, our debt has consisted entirely of borrowings collateralized by a pledge of our investment securities. These borrowings appear on our balance sheet as repurchase agreements. At December 31, 2007, we had established uncommitted borrowing facilities in this market with 30 lenders in amounts which we believe are in excess of our needs. All of our Investment Securities are currently accepted as collateral for these borrowings. However, we limit our borrowings, and thus our potential asset growth, in order to maintain unused borrowing capacity and thus increase the liquidity and strength of our balance sheet.

For the year ended December 31, 2007, the term to maturity of our borrowings ranged from one day to three years. Additionally, we have entered into structured borrowings giving the counterparty the right to call the balance prior to maturity. The weighted average original term to maturity of our borrowings was 286 days at December 31, 2007. For the year ended December 31, 2006, the term to maturity of our borrowings ranged from one day to three years, with a weighted average original term to maturity of 194 days at December 31, 2006. For the year ended December 31, 2005, the term to maturity of our borrowings ranged from one day to three years, with a weighted average original term to maturity of 163 days at December 31, 2005.

At December 31, 2007, the weighted average cost of funds for all of our borrowings was 4.76%, with the effect of the interest rate swaps, and the weighted average term to next rate adjustment was 234 days. At December 31, 2006, the weighted average cost of funds for all of our borrowings 5.14% and the weighted average term to next rate adjustment was 125 days. At December 31, 2005, the weighted average cost of funds for all of our borrowings was 4.16% and the weighted average term to next rate adjustment was 79 days.

### Liquidity

Liquidity, which is our ability to turn non-cash assets into cash, allows us to purchase additional investment securities and to pledge additional assets to secure existing borrowings should the value of our pledged assets decline. Potential immediate sources of liquidity

for us include cash balances and unused borrowing capacity. Unused borrowing capacity will vary over time as the market value of our investment securities varies. Our non-cash assets are largely actual or implied “AAA”-rated assets, and accordingly, we have not had, nor do we anticipate having, difficulty in converting our assets to cash. Our balance sheet also generates liquidity on an on-going basis through mortgage principal repayments and net earnings held prior to payment as dividends. Should our needs ever exceed these on-going sources of liquidity plus the immediate sources of liquidity discussed above, we believe that in most circumstances our investment securities could be sold to raise cash. The maintenance of liquidity is one of the goals of our capital investment policy. Under this policy, we limit asset growth in order to preserve unused borrowing capacity for liquidity management purposes.

Borrowings under our repurchase agreements increased by \$18.5 billion to \$46.0 billion at December 31, 2007, from \$27.5 billion at December 31, 2006. The increase in borrowings was the result of our deployment of additional capital raised during 2007, which permitted us to increase our borrowings.

We anticipate that, upon repayment of each borrowing under a repurchase agreement, we will use the collateral immediately for borrowing under a new repurchase agreement. We have not at the present time entered into any committed agreements under which the lender would be required to enter into new repurchase agreements during a specified period of time, nor do we presently plan to have liquidity facilities with commercial banks.

Under our repurchase agreements, we may be required to pledge additional assets to our repurchase agreement counterparties (i.e., lenders) in the event the estimated fair value of the existing pledged collateral under such agreements declines and such lenders demand additional collateral (a “margin call”), which may take the form of additional securities or cash. Similarly, if the estimated fair value of investment securities increases due to changes in market interest rates or market factors, lenders may release collateral back to us. Specifically, margin calls result from a decline in the value of our Mortgage-Backed Securities securing our repurchase agreements, prepayments on the mortgages securing such Mortgage-Backed Securities and to changes in the estimated fair value of such Mortgage-Backed Securities generally due to principal reduction of such Mortgage-Backed Securities from scheduled amortization and resulting from changes in market interest rates and other market factors. Through December 31, 2007, we did not have any margin calls on our repurchase agreements that we were not able to satisfy with either cash or additional pledged collateral. However, should prepayment speeds on the mortgages underlying our Mortgage-Backed Securities and/or market interest rates suddenly increase, margin calls on our repurchase agreements could result, causing an adverse change in our liquidity position.

The following table summarizes the effect on our liquidity and cash flows from contractual obligations for repurchase agreements, interest expense on repurchase agreements, the non-cancelable office lease and employment agreements at December 31, 2007.

### Contractual Obligations

(dollars in thousands)	Within One Year	One to Three Years	Three to Five Years	More than Five Years	Total
Repurchase agreements	\$39,646,560	\$3,100,000	\$1,800,000	\$1,500,000	\$46,046,560
Interest expense on repurchase agreements	384,255	427,089	215,223	262,993	1,289,560
Long-term operating lease obligations	532	532	—	—	1,064
Employment contracts	23,157	—	—	—	23,157
<b>Total</b>	<b>\$40,054,504</b>	<b>\$3,527,621</b>	<b>\$2,015,223</b>	<b>\$1,762,993</b>	<b>\$47,360,341</b>

### Stockholders' Equity

On January 23, 2008, we entered into an underwriting agreement pursuant to which we sold 58,650,000 shares of our common stock for net proceeds following underwriting expenses of approximately \$1.1 billion. This transaction settled on January 29, 2008.

During the year ended December 31, 2007, we declared dividends to common shareholders totaling \$339.8 million or \$1.04 per share, of which \$136.6 million was paid on January 28, 2008. During the year ended December 31, 2007, we declared and paid dividends to Series A Preferred shareholders totaling \$14.6 million or \$1.97 per share, and Series B Preferred shareholders totaling \$6.9 million or \$1.50. During the year ended December 31, 2006, we declared dividends to common shareholders totaling \$102.6 million or \$0.57 per share, of which \$39.0 million was paid on January 26, 2007. During the year ended December 31, 2006, we declared and paid dividends to Series A Preferred shareholders totaling \$14.6 million or \$1.97 per share, and Series B Preferred shareholders totaling \$5.0 million or \$1.08 per share.

On October 11, 2007, we entered into an underwriting agreement pursuant to which we sold 71,300,000 shares of our common stock for net proceeds following underwriting expenses of approximately \$1.0 billion. This transaction settled on October 17, 2007.

On July 12, 2007, we entered into an underwriting agreement pursuant to which we sold 54,050,000 shares of our common stock for proceeds of \$720.8 million net of underwriting fees. This transaction settled on July 18, 2007.

On March 7, 2007, we entered into an underwriting agreement pursuant to which we sold 57,500,000 shares of our common stock for net proceeds following underwriting expenses of approximately \$737.4 million. This transaction settled on March 13, 2007.

During the year ended December 31, 2007, we raised \$116.5 million by issuing 8.0 million shares through the Direct Purchase and Dividend Reinvestment Program.

During the year ended December 31, 2007, 55,738 options were exercised under the Long-Term Stock Incentive Plan, or Incentive Plan, for an aggregate exercise price of \$576,000.

On August 3, 2006, we entered into an ATM Equity Offering<sup>sm</sup> Sales Agreement with Merrill Lynch & Co. and Merrill Lynch, Pierce, Fen-

ner & Smith Incorporated, relating to the sale of shares of our common stock from time to time through Merrill Lynch. Sales of the shares, if any, are made by means of ordinary brokers' transaction on the New York Stock Exchange. During the year ended December 31, 2007, 4.5 million shares of our common stock were issued pursuant to this program, totaling \$66.2 million in net proceeds.

On August 3, 2006, we entered into an ATM Equity Sales Agreement with UBS Securities LLC, relating to the sale of shares of our common stock from time to time through UBS Securities. Sales of the shares, if any, will be made by means of ordinary brokers' transaction on the New York Stock Exchange. During the year ended December 31, 2007, 1.1 million shares of our common stock were issued pursuant to this program, totaling \$14.7 million in net proceeds.

On August 16, 2006, we entered into an underwriting agreement pursuant to which we sold 40,825,000 shares of our common stock for net proceeds before expenses of approximately \$476.7 million. This transaction settled on August 22, 2006.

On April 6, 2006, we entered into an underwriting agreement pursuant to which we sold 39,215,000 shares of our common stock for net proceeds before expenses of approximately \$437.7 million. On April 6, 2006, we entered into a second underwriting agreement pursuant to which we sold 4,600,000 shares of our 6% Series B Cumulative Convertible Preferred Stock for net proceeds before expenses of approximately \$111.5 million. Each of these transactions settled on April 12, 2006. The 6% Series B Cumulative Preferred Stock has been treated under GAAP as temporary equity. For the purpose of computing ratios relating to equity measures, the Series B Preferred Stock has been included in equity.

During the year ended December 31, 2006, 22,160 options were exercised under the Incentive Plan for an aggregate exercise price of \$183,000.

During the year ended December 31, 2006 we sold 500,000 shares of our common stock, for net proceeds of \$6.7 million, under the ATM Equity Sales Agreement with Merrill Lynch and we did not sell any shares under the ATM Equity Sales Agreement with UBS Securities. During the year ended December 31, 2006, we sold 1.1 million shares of our common stock for net proceeds of \$14.2 million under our Equity Shelf Program with UBS Securities, pursuant to which sales are made by means of ordinary brokers' transaction on the New York Stock Exchange.

## Unrealized Gains and Losses

With our “available-for-sale” accounting treatment, unrealized fluctuations in market values of assets do not impact our GAAP or taxable income but rather are reflected on our balance sheet by changing the carrying value of the asset and stockholders’ equity under “Accumulated Other Comprehensive Income (Loss).” By accounting for our assets in this manner, we hope to provide useful information to stockholders and creditors and to preserve

flexibility to sell assets in the future without having to change accounting methods.

As a result of this mark-to-market accounting treatment, our book value and book value per share are likely to fluctuate far more than if we used historical amortized cost accounting. As a result, comparisons with companies that use historical cost accounting for some or all of their balance sheet may not be meaningful.

The table below shows unrealized gains and losses on the Investment Securities, available-for-sale equity securities and interest rate swaps in our portfolio.

## Unrealized Gains and Losses

(dollars in thousands)	At December 31				
	2007	2006	2005	2004	2003
Unrealized gain	\$379,348	\$112,596	\$5,027	\$23,021	\$24,886
Unrealized loss	(531,545)	(188,708)	(211,601)	(143,821)	(72,147)
Net Unrealized (loss) gain	(\$152,197)	(\$76,112)	(\$206,574)	(\$120,800)	(\$47,261)

Unrealized changes in the estimated net market value of investment securities have one direct effect on our potential earnings and dividends: positive mark-to-market changes increase our equity base and allow us to increase our borrowing capacity while negative changes tend to limit borrowing capacity under our capital investment policy. A very large negative change in the net market value of our investment securities might impair our liquidity position, requiring us to sell assets with the likely result of realized losses upon sale.

## Leverage

Our debt-to-equity ratio at December 31, 2007, 2006 and 2005 was 8.7:1, 10.4:1 and 9.0:1, respectively. We generally expect to maintain a ratio of debt-to-equity of between 8:1 and 12:1, although the ratio may vary from time to time based upon various factors, including our management’s opinion of the level of risk of our assets and liabilities, our liquidity position, our level of unused borrowing capacity and over-collateralization levels required by lenders when we pledge assets to secure borrowings.

Our target debt-to-equity ratio is determined under our capital investment policy. Should our actual debt-to-equity ratio increase above the target level due to asset acquisition or market value fluctuations in assets, we cease to acquire new assets. Our management will, at that time, present a plan to our board of directors to bring us back to our target debt-to-equity ratio; in many circumstances, this would be accomplished over time by the monthly reduction of the balance of our Mortgage-Backed Securities through principal repayments.

## Asset/Liability Management and Effect of Changes in Interest Rates

We continually review our asset/liability management strategy with respect to interest rate risk, mortgage prepayment risk, credit risk and the related issues of capital adequacy and liquidity. Our goal is to provide attractive risk-adjusted stockholder returns while maintaining what we believe is a strong balance sheet.

We seek to manage the extent to which our net income changes as a function of changes in interest rates by matching adjustable-rate assets with variable-rate borrowings. In addition, we have attempted to mitigate the potential impact on net income of periodic and lifetime coupon adjustment restrictions in our portfolio of investment securities by entering into interest rate swaps. At December 31, 2007, we had entered into swap agreements with a total notional amount of \$16.2 billion. We agreed to pay a weighted average pay rate of 5.03% and receive a floating rate based on one month LIBOR. At December 31, 2006, we entered into swap agreements with a total notional amount of \$9.3 billion. We agreed to pay a weighted average pay rate of 5.17% and receive a floating rate based on one month LIBOR. We may enter into similar derivative transactions in the future by entering into interest rate collars, caps or floors or purchasing interest only securities.

Changes in interest rates may also affect the rate of mortgage principal prepayments and, as a result, prepayments on mortgage-backed securities. We seek to mitigate the effect of changes in the mortgage principal repayment rate by balancing assets we purchase at a premium with assets we purchase at a discount. To date, the aggregate premium exceeds the aggregate discount on our mortgage-backed securities. As a result, prepayments, which result in the expensing of unamortized premium, will reduce our net income compared to what net income would be absent such prepayments.

## Off-Balance Sheet Arrangements

We do not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Further, we have not guaranteed any obligations of unconsolidated entities nor do we have any commitment or intent to provide funding to any such entities. As such, we are not materially exposed to any market, credit, liquidity or financing risk that could arise if we had engaged in such relationships.

## Capital Resources

At December 31, 2007, we had no material commitments for capital expenditures.

## Inflation

Virtually all of our assets and liabilities are financial in nature. As a result, interest rates and other factors drive our performance far more than does inflation. Changes in interest rates do not necessarily correlate with inflation rates or changes in inflation rates. Our financial statements are prepared in accordance with GAAP and our dividends are based upon our net income as calculated for tax purposes; in each case, our activities and balance sheet are measured with reference to historical cost or fair market value without considering inflation.

## Other Matters

We calculate that at least 75% of our assets were qualified REIT assets, as defined in the Code for the years ended December 31, 2007 and 2006. We also calculate that our revenue qualifies for the 75% source of income test and for the 95% source of income test rules for the years ended December 31, 2007 and 2006. Consequently, we met the REIT income and asset test. We also met all REIT requirements regarding the ownership of our common stock and the

distribution of our net income. Therefore, for the years ended of December 31, 2007, 2006, and 2005, we believe that we qualified as a REIT under the Code.

We at all times intend to conduct our business so as not to become regulated as an investment company under the Investment Company Act of 1940, or the Investment Company Act. If we were to become regulated as an investment company, then our use of leverage would be substantially reduced. The Investment Company Act exempts entities that are “primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate” (qualifying interests). Under current interpretation of the staff of the SEC, in order to qualify for this exemption, we must maintain at least 55% of our assets directly in qualifying interests and at least 80% of our assets in qualifying interests plus other real estate related assets. In addition, unless certain mortgage securities represent all the certificates issued with respect to an underlying pool of mortgages, the Mortgage-Backed Securities may be treated as securities separate from the underlying mortgage loans and, thus, may not be considered qualifying interests for purposes of the 55% requirement. We calculate that as of December 31, 2007 and December 31, 2006, we were in compliance with this requirement.

## MANAGEMENT REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Dated: February 23, 2008

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rules 13a-15(f) under the Securities Exchange Act as a process designed by, or under the supervision of, the Company’s principal executive and principal financial officers and effected by the Company’s Board of Directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. As a result, even systems determined to be effective can provide only reasonable assurance regarding the preparation and presentation of financial statements. Moreover, projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

The Company’s management assessed the effectiveness of the Company’s internal control over financial reporting as of December 31, 2007. In making this assessment, the Company’s management used criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control-Integrated Framework*.

Based on management’s assessment, the Company’s management believes that, as of December 31, 2007, the Company’s internal control over financial reporting was effective based on those criteria. There have been no changes in the Company’s internal controls over financial reporting that occurred during the quarter ended December 31, 2007 that have materially affected, or are reasonably likely to affect its internal control over financial reporting.

The Company’s independent registered public accounting firm, Deloitte & Touche LLP, has issued an attestation report on the Company’s internal control over financial reporting.

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of Annaly Capital Management, Inc.  
New York, New York

We have audited the accompanying consolidated statements of financial condition of Annaly Capital Management, Inc. and subsidiaries (the “Company”) as of December 31, 2007 and 2006, and the related consolidated statements of operations and comprehensive income (loss), stockholders’ equity, and cash flows for each of the three years in the period ended December 31, 2007. We also have audited the Company’s internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company’s management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management Report On Internal Control Over Financial Reporting at Item 9A. Our responsibility is to express an opinion on these financial statements and an opinion on the Company’s internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and valuating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company’s internal control over financial reporting is a process designed by, or under the supervision of, the company’s principal executive and principal financial officers, or persons performing similar functions, and effected by the company’s board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Annaly Capital Management, Inc. and subsidiaries as of December 31, 2007 and 2006, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2007, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on the criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

*Deloitte & Touche LLP*

New York, New York  
February 26, 2008

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

December 31, 2007, and 2006

(dollars in thousands, except for share data)	DECEMBER 31, 2007	DECEMBER 31, 2006
<b>Assets</b>		
Cash and cash equivalents	\$ 103,960	\$ 91,782
Mortgage-Backed Securities, at fair value	52,879,528	30,167,509
Agency debentures, at fair value	253,915	49,500
Available for sale equity securities, at fair value	64,754	—
Trading securities, at fair value	11,675	18,365
Receivable for Mortgage-Backed Securities sold	276,737	200,535
Accrued interest receivable	271,996	146,089
Receivable for advisory and service fees	3,598	3,178
Intangible for customer relationships, net	9,842	11,184
Goodwill	22,966	22,966
Interest rate swaps, at fair value	—	2,558
Other assets	4,543	2,314
<b>Total assets</b>	<b>\$53,903,514</b>	<b>\$30,715,980</b>
<b>Liabilities &amp; Stockholders' Equity</b>		
<b>Liabilities:</b>		
Repurchase agreements	\$46,046,560	\$27,514,020
Payable for Investment Securities purchased	1,677,131	338,172
Trading securities sold, not yet purchased, at fair value	32,835	41,948
Accrued interest payable	257,608	83,998
Dividends payable	136,618	39,016
Accounts payable	36,688	18,816
Interest rate swaps, at fair value	398,096	20,179
<b>Total liabilities</b>	<b>48,585,536</b>	<b>28,056,149</b>
Minority interest in equity of consolidated affiliate	1,574	5,324
6.00% Series B Cumulative Convertible Preferred Stock: 4,600,000 shares authorized, issued and outstanding	111,466	111,466
Commitments and contingencies (Note 11)		
<b>Stockholders' Equity:</b>		
7.875% Series A Cumulative Redeemable Preferred Stock: 7,637,500 shares authorized 7,412,500 issued and outstanding	177,088	177,088
Common stock: par value \$.01 per share; 487,762,500 shares authorized, 401,822,703 and 205,345,591 issued and outstanding, respectively	4,018	2,053
Additional paid-in capital	5,297,922	2,615,016
Accumulated other comprehensive loss	(152,197)	(76,112)
Accumulated deficit	(121,893)	(175,004)
<b>Total stockholders' equity</b>	<b>5,204,938</b>	<b>2,543,041</b>
<b>Total liabilities, minority interest, Series B Preferred Stock and stockholders' equity</b>	<b>\$53,903,514</b>	<b>\$30,715,980</b>

See notes to consolidated financial statements.



## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

Years Ended December 31, 2007, 2006, and 2005

(dollars in thousands, except for per share data)	For the Year Ended		
	December 31, 2007	December 31, 2006	December 31, 2005
Interest income	\$2,355,447	\$1,221,882	\$705,046
Interest expense	1,926,465	1,055,013	568,560
Net interest income	428,982	166,869	136,486
Other income (loss):			
Investment advisory and service fees	22,028	22,351	35,625
Gain (loss) on sale of Investment Securities	19,062	(3,862)	(53,238)
Gain on termination of interest rate swaps	2,096	10,674	—
Income from trading securities	19,147	3,994	—
Dividend income from available-for-sale equity securities	91	—	—
Loss on other-than-temporarily impaired securities	(1,189)	(52,348)	(83,098)
Total other income (loss)	61,235	(19,191)	(100,711)
Expenses:			
Distribution fees	3,647	3,444	8,000
General and administrative expenses	62,666	40,063	26,278
Total expenses	66,313	43,507	34,278
Impairment of intangible for customer relationships	—	2,493	—
Income before income taxes and minority interest	423,904	101,678	1,497
Income taxes	8,870	7,538	10,744
Income (loss) before minority interest	415,034	94,140	(9,247)
Minority interest	650	324	—
Net income (loss)	414,384	93,816	(9,247)
Dividends on preferred stock	21,493	19,557	14,593
Net income available (loss related) to common shareholders	\$392,891	\$74,259	(\$23,840)
Net income available (loss related) to common shareholders per average common share:			
Basic	\$1.32	\$0.44	(\$0.19)
Diluted	\$1.31	\$0.44	(\$0.19)
Weighted average number of common shares outstanding:			
Basic	297,488,394	167,666,631	122,475,032
Diluted	306,263,766	167,746,387	122,475,032
Net income (loss)	\$414,384	\$93,816	(\$9,247)
Comprehensive income (loss):			
Unrealized gain (loss) on available-for-sale securities	322,264	91,873	(222,110)
Unrealized loss on interest rate swaps	(378,380)	(6,404)	(543)
Reclassification adjustment for net gains (losses) included in net income or loss	(19,969)	45,536	136,336
Other comprehensive income (loss)	(76,085)	131,005	(86,317)
Comprehensive income (loss)	\$338,299	\$224,821	(\$95,564)

See notes to consolidated financial statements.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

Years Ended December 31, 2007, 2006, and 2005

(dollars in thousands, except per share data)	Preferred Stock	Common Stock Par Value	Other Additional Paid-In Capital	Accumulated Comprehensive Income (Loss)	Retained (Deficit) Earnings	Total
<b>Balance, December 31, 2004</b>	\$177,077	\$1,213	\$1,638,635	(\$120,800)	\$ 4,345	\$1,700,470
Net loss	—	—	—	—	(9,247)	—
Other comprehensive loss	—	—	—	(86,317)	—	—
Comprehensive loss	—	—	—	—	—	(95,564)
Reduction in estimated legal cost of preferred offering	11	—	—	—	—	11
Exercise of stock options	—	—	253	—	—	253
Net proceeds from direct purchase and dividend reinvestment	—	—	440	—	—	440
Net proceeds from equity shelf program	—	24	40,124	—	—	40,148
Preferred dividends declared, \$1.97 per share	—	—	—	—	(14,593)	(14,593)
Common dividends declared, \$1.04 per share	—	—	—	—	(127,142)	(127,142)
<b>Balance, December 31, 2005</b>	<b>177,088</b>	<b>1,237</b>	<b>1,679,452</b>	<b>(207,117)</b>	<b>(146,637)</b>	<b>\$1,504,023</b>
Net income	—	—	—	—	93,816	—
Other comprehensive income	—	—	—	131,005	—	—
Comprehensive income	—	—	—	—	—	224,821
Exercise of stock options	—	—	183	—	—	183
Option expense	—	—	1,285	—	—	1,285
Net proceeds from follow-on offerings	—	800	913,200	—	—	914,000
Net proceeds from equity shelf program	—	16	20,896	—	—	20,912
Preferred Series A dividends declared \$1.97 per share	—	—	—	—	(14,594)	(14,594)
Preferred Series B dividends declared \$1.08 per share	—	—	—	—	(4,966)	(4,966)
Common dividends declared, \$0.57 per share	—	—	—	—	(102,623)	(102,623)
<b>Balance, December 31, 2006</b>	<b>177,088</b>	<b>72,053</b>	<b>2,615,016</b>	<b>(76,112)</b>	<b>(175,004)</b>	<b>2,543,041</b>
Net income	—	—	—	—	414,384	—
Other comprehensive loss	—	—	—	(76,085)	—	—
Comprehensive income	—	—	—	—	—	338,299
Exercise of stock options	—	—	576	—	—	576
Option and long-term compensation expense	—	—	1,355	—	—	1,355
Net proceeds from follow-on offerings	—	1,829	2,483,700	—	—	2,485,529
Net proceeds from ATM program	—	56	80,862	—	—	80,918
Net proceeds from direct purchase and dividend reinvestment	—	80	116,413	—	—	116,493
Preferred Series A dividends declared \$1.97 per share	—	—	—	—	(14,593)	(14,593)
Preferred Series B dividends declared \$1.50 per share	—	—	—	—	(6,900)	(6,900)
Common dividends declared, \$1.04 per share	—	—	—	—	(339,780)	(339,780)
<b>Balance, December 31, 2007</b>	<b>\$177,088</b>	<b>\$4,018</b>	<b>\$5,297,922</b>	<b>(\$152,197)</b>	<b>(\$121,893)</b>	<b>\$5,204,938</b>

See notes to consolidated financial statements.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended December 31, 2007, 2006, and 2005

(dollars in thousands)	December 31, 2007	For the Year Ended December 31, 2006	December 31, 2005
<b>Cash flows from operating activities:</b>			
Net income (loss)	\$414,384	\$93,816	(\$9,247)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Amortization of Mortgage Backed Securities premiums and discounts, net	65,185	63,625	154,309
Amortization of intangibles	1,377	1,589	571
Amortization of trading securities premiums and discounts	(11)	—	—
Loss (gain) on sale of Investment Securities	(19,062)	3,862	53,238
Gain on termination of interest rate swaps	(2,096)	(10,674)	—
Stock option and long-term compensation expense	1,355	1,285	56
Net realized gain on trading investments	(4,430)	(1,200)	—
Unrealized (appreciation) depreciation on trading investments	(11,013)	1,180	—
Market value adjustment on long-term repurchase agreements	—	(149)	(2,514)
Loss on other-than-temporarily impaired securities	1,189	52,348	83,098
Impairment of intangibles	—	2,493	—
(Increase) decrease in accrued interest receivable	(123,322)	(76,224)	10,555
Increase in other assets	(2,264)	(238)	(425)
Purchase of trading investments	(18,479)	(44,200)	—
Proceeds from sale of trading securities	23,640	28,838	—
Purchase of trading securities sold, not yet purchased	(13,620)	(16,096)	—
Proceeds for securities sold, not yet purchased	21,489	55,073	—
(Decrease) increase in advisory and service fees receivable	(420)	319	(1,138)
Increase (decrease) in interest payable	173,610	56,004	(7,727)
Increase in accrued expenses and other liabilities	17,872	9,978	753
Net cash provided by operating activities	525,384	221,629	281,529
<b>Cash flows from investing activities:</b>			
Purchase of Mortgage-Backed Securities	(32,832,687)	(23,196,076)	(7,416,869)
Proceeds from sale of Investment Securities	4,847,909	3,040,984	3,231,219
Principal payments of Mortgage-Backed Securities	6,831,406	5,115,693	7,053,867
Purchase of agency debentures	(256,241)	—	—
Proceeds from called agency debentures	—	—	130,000
Purchase of equity investment	(54,324)	—	—
Net cash (used in) provided by investing activities	(21,463,937)	(15,039,399)	2,998,217
<b>Cash flows from financing activities:</b>			
Proceeds from repurchase agreements	393,750,907	292,418,807	245,514,548
Principal payments on repurchase agreements	(375,218,367)	(278,481,088)	(248,646,126)
Proceeds from exercise of stock options	576	183	197
Proceeds from termination of interest rate swaps	2,096	10,674	—
Proceeds from direct purchase and dividend reinvestment	116,493	—	440
Net proceeds from follow-on offerings	2,485,529	914,000	—
Net proceeds from preferred stock offering	—	111,466	—
Net proceeds from equity shelf program and ATM Equity Sales Agreement	80,918	20,912	40,148
Minority interest	(3,750)	5,324	—
Dividends paid	(263,671)	(95,534)	(189,998)
Net cash provided by (used in) financing activities	20,950,731	14,904,744	(3,280,791)
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>12,178</b>	<b>86,974</b>	<b>(1,045)</b>
<b>Cash and cash equivalents, beginning of year</b>	<b>91,782</b>	<b>4,808</b>	<b>5,853</b>
<b>Cash and cash equivalents, end of year</b>	<b>\$103,960</b>	<b>\$91,782</b>	<b>\$4,808</b>
<b>Supplemental disclosure of cash flow information:</b>			
Interest paid	\$1,752,855	\$999,009	\$576,287
Taxes paid	\$10,272	\$7,242	\$11,740
<b>Noncash financing activities:</b>			
Net change in unrealized loss on available-for-sale securities and interest rate swaps, net of reclassification adjustment	(\$76,085)	\$131,005	(\$86,317)
Dividends declared, not yet paid	\$136,618	\$39,016	\$12,368

See notes to consolidated financial statements.

**ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

Years Ended December 31, 2007, 2006, and 2005

**1. Organization and Significant Accounting Policies**

Annaly Capital Management, Inc. (the “Company”) was incorporated in Maryland on November 25, 1996. The Company changed its name from Annaly Mortgage Management, Inc. to Annaly Capital Management, Inc. effective August 2, 2006. The Company commenced its operations of purchasing and managing an investment portfolio of mortgage-backed securities on February 18, 1997, upon receipt of the net proceeds from the private placement of equity capital. An initial public offering was completed on October 14, 1997. The Company is a real estate investment trust (REIT) under the Internal Revenue Code of 1986, as amended. The Company acquired Fixed Income Discount Advisory Company (“FIDAC”) on June 4, 2004. FIDAC is a registered investment advisor and is a taxable REIT subsidiary of the Company. On June 27, 2006, the Company made a majority equity investment in an affiliated investment fund (the “Fund”). The Company acquired approximately 3.6 million shares of common stock of Chimera Investment Corporation (“Chimera”) for approximately \$54.3 million on November 21, 2007. Chimera is a newly-formed, publicly traded, specialty finance company that invests in residential mortgage loans, residential mortgage-backed securities, real estate related securities and various other asset classes. Chimera is externally managed by FIDAC and intends to elect and qualify to be taxed as a REIT for federal income tax purposes.

*A summary of the Company’s significant accounting policies follows:*

The consolidated financial statements include the accounts of the Company, FIDAC and the Fund. All intercompany balances and transactions have been eliminated. The minority shareholder’s interest in the Fund is reflected as minority interest in the consolidated financial statements.

**Cash and Cash Equivalents** – Cash and cash equivalents include cash on hand and money market funds.

**Mortgage-Backed Securities and Agency Debentures** – The Company invests primarily in mortgage pass-through certificates, collateralized mortgage obligations and other mortgage-backed securities representing interests in or obligations backed by pools of mortgage loans (collectively, “Mortgage-Backed Securities”). The Company also invests in agency debentures issued by Federal Home Loan Bank (“FHLB”), Federal Home Loan Mortgage Corporation (“FHLMC”), and Federal National Mortgage Association (“FNMA”). The Mortgage-Backed Securities and agency debentures are collectively referred to herein as “Investment Securities.”

Statement of Financial Accounting Standards (“SFAS”) No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, requires the Company to classify its Investment Securities as either trading investments, available-for-sale investments or held-to-maturity investments. Although the Company generally intends to hold most of its Investment Securities until maturity, it may, from

time to time, sell any of its Investment Securities as part of its overall management of its portfolio. Accordingly, SFAS No. 115 requires the Company to classify all of its Investment Securities as available-for-sale. All assets classified as available-for-sale are reported at estimated fair value, based on market prices from independent sources, with unrealized gains and losses excluded from earnings and reported as a separate component of stockholders’ equity. The investment in Chimera is accounted for as available-for-sale under the provisions of SFAS 115.

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been lower than carrying value, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Unrealized losses on Investment Securities that are considered other than temporary, as measured by the amount of decline in fair value attributable to other-than-temporary factors, are recognized in income and the cost basis of the Investment Securities is adjusted. The loss on other-than-temporarily impaired securities was \$1.2 million, \$52.3 million and \$83.1 million during the years ended December 31, 2007, 2006 and 2005, respectively.

SFAS No. 107, *Disclosure About Fair Value of Financial Instruments*, requires disclosure of the fair value of financial instruments for which it is practicable to estimate that value. The estimated fair value of Investment Securities and interest rate swaps is equal to their carrying value presented in the consolidated statements of financial condition. The estimated fair value of trading securities and trading securities sold, not yet purchased, is equal to their carrying value presented in the consolidated statements of financial condition. The estimated fair value of cash and cash equivalents, accrued interest receivable, receivable for securities sold, receivable for advisory and service fees, repurchase agreements with maturities shorter than one year, and payable for mortgage-backed securities purchased, dividends payable, accounts payable, and accrued interest payable, generally approximates cost as of December 31, 2007 due to the short term nature of these financial instruments.

Interest income is accrued based on the outstanding principal amount of the Investment Securities and their contractual terms. Premiums and discounts associated with the purchase of the Investment Securities are amortized into interest income over the projected lives of the securities using the interest method. The Company’s policy for estimating prepayment speeds for calculating the effective yield is to evaluate historical performance, consensus prepayment speeds, and current market conditions.

Investment Securities transactions are recorded on the trade date. Purchases of newly-issued securities are recorded when all signifi-

cant uncertainties regarding the characteristics of the securities are removed, generally shortly before settlement date. Realized gain and losses on sale of Investment Securities are determined on the specific identification method.

**Derivative Financial Instruments/Hedging Activity** – The Company hedges interest rate risk through the use of derivative financial instruments, comprised of interest rate caps and interest rate swaps (collectively, “Hedging Instruments”). The Company accounts for Hedging Instruments in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, (“SFAS 133”) as amended and interpreted. The Company carries all Hedging Instruments at their fair value, as assets, if their fair value is positive, or as liabilities, if their fair value is negative. As the Company’s interest rate swaps are designated as cash flow hedges under SFAS No. 133, the change in the fair value of any such derivative is recorded in other comprehensive income or loss for hedges that qualify as effective. At December 31, 2007, the Company did not have any interest rate caps. The ineffective amount of all Hedging Instruments, if any, is recognized in earnings each year. To date, the Company has not recognized any change in the value of its interest rate swaps in earnings as a result of the hedge or a portion thereof being ineffective.

Upon entering into hedging transactions, the Company documents the relationship between the Hedging Instruments and the hedged liability. The Company also documents its risk-management policies, including objectives and strategies, as they relate to its hedging activities. The Company assesses, both at inception of a hedge and on an on-going basis, whether or not the hedge is “highly effective,” as defined by SFAS 133. The Company discontinues hedge accounting on a prospective basis with changes in the estimated fair value reflected in earnings when (i) it is determined that the derivative is no longer effective in offsetting cash flows of a hedged item (including hedged items such as forecasted transactions); (ii) it is no longer probable that the forecasted transaction will occur; or (iii) it is determined that designating the derivative as a Hedging Instrument is no longer appropriate.

When the Company enters into an interest rate swap, it agrees to pay a fixed rate of interest and to receive a variable interest rate, generally based on the London Interbank Offered Rate (“LIBOR”). The Company’s interest rate swaps are designated as cash flow hedges against the benchmark interest rate risk associated with the Company’s borrowings.

All changes in the unrealized gains/losses on any interest rate swap are recorded in accumulated other comprehensive income or loss and are reclassified to earnings as interest expense is recognized on the Company’s hedged borrowings. If it becomes probable that the forecasted transaction, which in this case refers to interest payments to be made under the Company’s short-term borrowing agreements, will not occur by the end of the originally specified time period, as documented at the inception of the hedging relationship, then the related gain or loss in accumulated other comprehensive income or loss would be reclassified to income or loss.

Realized gains and losses resulting from the termination of an interest rate swap are initially recorded in accumulated other comprehensive income or loss as a separate component of stockholders’ equity. The gain or loss from a terminated interest rate swap remains in accumulated other comprehensive income or loss until the forecasted interest payments affect earnings. If it becomes probable that the forecasted interest payments will not occur, then the entire gain or loss would be recognized in earnings.

**Credit Risk** – The Company has limited its exposure to credit losses on its portfolio of Investment Securities by only purchasing securities issued by FHLMC, FNMA, or GNMA. The payment of principal and interest on the FHLMC and FNMA Mortgage-Backed Securities are guaranteed by those respective agencies, and the payment of principal and interest on the GNMA Mortgage-Backed Securities are backed by the full faith and credit of the U.S. government. All of the Company’s Investment Securities have an actual or implied “AAA” rating.

**Trading Securities and Trading Securities sold, not yet purchased** – Trading securities and trading securities sold, not yet purchased, are presented in the consolidated statements of financial conditions as a result of consolidating the financial statements of the Fund, and are carried at fair value at December 31, 2007. The realized and unrealized gains and losses, as well as other income or loss from trading securities, are recorded in the income from trading securities balance in the accompanying consolidated statements of operations.

Trading securities sold, not yet purchased, represent obligations of the Fund to deliver the specified security at the contracted price, and thereby create a liability to purchase the security in the market at prevailing prices.

**Repurchase Agreements** – The Company finances the acquisition of its Investment Securities through the use of repurchase agreements. Repurchase agreements are treated as collateralized financing transactions and are carried at their contractual amounts, including accrued interest, as specified in the respective agreements.

**Cumulative Convertible Preferred Stock** – The Company classifies its Series B Cumulative Convertible Preferred Stock on the consolidated statements of financial condition using the guidance in SEC Accounting Series Release No. 268, *Presentation in Financial Statements of “Redeemable Preferred Stocks,”* and Emerging Issues Task Force (“EITF”) Topic D-98, *Classification and Measurement of Redeemable Securities*. The Series B Cumulative Convertible Preferred Stock contains fundamental change provisions that allow the holder to redeem the preferred stock for cash if certain events occur. As redemption under these provisions is not solely within the Company’s control, the Company has classified the Series B Cumulative Convertible Preferred Stock as temporary equity in the accompanying consolidated statement of financial condition.

The Company has analyzed whether the embedded conversion option should be bifurcated under the guidance in SFAS No. 133 and EITF Issue No. 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company’s Own Stock*, and has determined that bifurcation is not necessary.

**Income Taxes** – The Company has elected to be taxed as a REIT and intends to comply with the provisions of the Internal Revenue Code of 1986, as amended (the “Code”), with respect thereto. Accordingly, the Company will not be subjected to federal income tax to the extent of its distributions to shareholders and as long as certain asset, income and stock ownership tests are met. The Company and FIDAC have made a joint election to treat FIDAC as a taxable REIT subsidiary. As such, FIDAC is taxable as a domestic C corporation and subject to federal and state and local income taxes based upon its taxable income.

**Use of Estimates** – The preparation of the consolidated financial statements in conformity with Generally Accepted Accounting Principles or (“GAAP”), requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Goodwill and Intangible Assets** – The Company’s acquisition of FIDAC was accounted for using the purchase method. Under the purchase method, net assets and results of operations of acquired companies are included in the consolidated financial statements from the date of acquisition. In addition, the cost of FIDAC was allocated to the assets acquired, including identifiable intangible assets, and the liabilities assumed based on their estimated fair values at the date of acquisition. The excess of purchase price over the fair value of the net assets acquired was recognized as goodwill. Intangible assets are periodically (but not less frequently than annually) reviewed for potential impairment. Intangible assets with an estimated useful life are expected to amortize over a 7.8 year weighted average time period. During the year ended December 31, 2007, there were no impairment losses. During the year ended December 31, 2006 the Company recognized \$2.5 million in impairment losses on intangible assets relating to customer relationships. During the year ended December 31, 2005, the Company did not have impairment losses.

**Stock Based Compensation** – On December 16, 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (Revised 2004) – *Share-Based Payment* (“SFAS 123R”). SFAS 123R, which replaced SFAS 123, requires the Company to measure and recognize in the consolidated financial statements the compensation cost relating to share-based payment transactions. The compensation cost should be reassessed based on the fair value of the equity instruments issued. The Company adopted SFAS 123R effective January 1, 2006 under the modified prospective transition method. Accordingly, prior period amounts have not been restated. Under this application, the Company is required to record compensation expense for all awards granted or modified on or after January 1, 2006 and for the unvested portion of all outstanding awards that remain outstanding at the date of adoption.

The Company elected to recognize compensation expense on a straight-line basis over the requisite service period for the entire award (that is, over the requisite service period of the last separately vesting portion of the award). The Company estimated fair value using the Black-Scholes valuation model. The Company granted

687,250 options during the year ended December 31, 2007. During the year ended December 31, 2007, the Company granted 7,000 shares of restricted common stock to certain of its employees. As of December 31, 2007, 5,250 of these restricted shares were unvested and subject to forfeiture.

**Recent Accounting Pronouncements** – In February 2006, the FASB issued FAS No. 155, *Accounting for Certain Hybrid Instruments, an amendment of FASB Statements No. 133 and 140* (“SFAS 155”). Among other things, SFAS 155: (i) permits fair value re-measurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation; (ii) clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS 133; (iii) establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation; (iv) clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives; and (v) amends SFAS 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. SFAS 155 was effective for all financial instruments acquired or issued by the Company after January 1, 2007. Securitized interests which only contain an embedded derivative that is tied to the prepayment risk of the underlying prepayable financial assets and for which the investor does not control the right to accelerate the settlement of such financial assets are excluded under a scope exception adopted by the FASB. None of the Company’s assets were subject to SFAS 155 as a result of this scope exception. Consequently, the Company has continued to record changes in the market value of its investment securities through Other Comprehensive Income, a component of stockholders’ equity. Therefore, the adoption of SFAS 155 did not have any impact on the Company’s consolidated financial statements.

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109* (“FIN 48”), and related implementation issues. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in the Company’s financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a threshold and measurement attribute for recognition in the financial statements of an asset or liability resulting from a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 was effective for the Company on January 1, 2007. There was no impact to the Company’s financial statements from implementing this new standard.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (“SFAS 157”). SFAS 157 defines fair value, establishes a framework for measuring fair value and requires enhanced disclosures about fair value measurements. SFAS 157 requires companies to disclose the fair value of its financial instruments according to a fair value hierarchy (i.e., levels 1, 2, and 3, as defined). Additionally, companies are required to provide enhanced disclosure regarding instruments in the level 3 category (the valuation of which

require significant management judgment), including a reconciliation of the beginning and ending balances separately for each major category of assets and liabilities. SFAS 157 is effective for the Company on January 1, 2008. The Company does not believe that the adoption of SFAS 157 will have a significant impact on its financial position or results of operations the manner in which it estimates fair value, but expects that adoption will increase footnote disclosure to comply with SFAS 157 disclosure requirements for financial statements issued after January 1, 2008.

In February 2007, the FASB issued SFAS No 159, *The Fair Value Option for Financial Assets and Financial Liabilities – including an amendment of FASB Statement No. 115* (“SFAS 159”). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected will be recognized in earnings at each subsequent reporting date SFAS 159 is effective for the Company commencing January 1, 2008. The Company did not elect the fair value option for any existing eligible financial instruments.

**Proposed FASB Staff Position** – The FASB issued a proposed FASB Staff Position (“FSP”) FAS No. 140-d relating to FASB Statement No. 140, *Accounting for Transfers of Financial Assets and Repurchase Financing Transactions* to address situations where assets purchased from a particular counterparty and financed through a repurchase agreement with the same counterparty can be considered and accounted for as separate transactions. Currently, the Company records such assets and the related financing on a gross basis in the consolidated statement of financial condition, and the corresponding

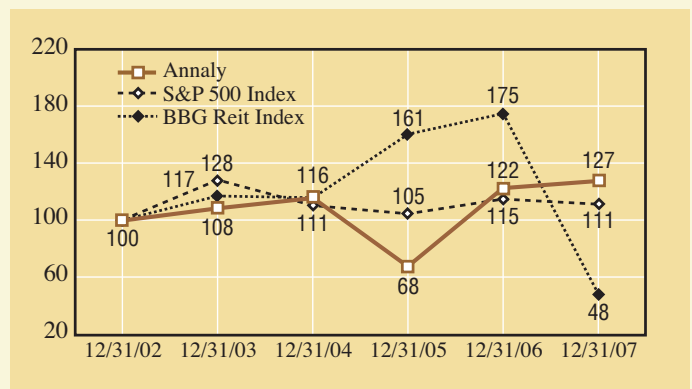
interest income and interest expense in the Company’s consolidated statement of operations and comprehensive income (loss). For assets representing available-for-sale investment securities, as in the Company’s case, any change in fair value is reported through other comprehensive income under SFAS 115, with the exception of impairment losses, which are recorded in the consolidated statement of operations and comprehensive (loss) income as realized losses.

FASB’s proposed staff position requires that all of the following criteria be met in order to continue the application of SFAS 140 as described above: (1) the initial transfer of and repurchase financing cannot be contractually contingent; (2) the repurchase financing entered into between the parties provides full recourse to the transferee and the repurchase price is fixed; (3) the financial asset is “readily obtainable” in the marketplace and the transfer is executed at market rates; (4) the borrower maintains the right to the collateral and the lender cannot re-pledge the asset prior to settlement of the repurchase agreement; and (4) the repurchase agreement and financial asset do not mature simultaneously.

At this time, the Company believes that its purchases and subsequent financing through repurchase agreements with the same counterparty meet the criteria enumerated in the proposed FSP FAS No. 140-d for treatment as a non-linked transfer and repurchase under SFAS No. 140 and the Company believes that if the FSP is ultimately issued in substantially its current form, there will be no effect on the manner in which the Company records such assets, their financings, and the corresponding interest income and interest expense. FSP FAS No. 140-d may be subject to significant changes prior to finalization, which may impact the Company’s current assessment of its impact.

## SHARE PERFORMANCE ANALYSIS (UNAUDITED)

The following graph and table set forth certain information comparing the yearly percentage change in cumulative total return on the Company’s Common Stock to the cumulative total return of the Standard & Poor’s 500 Index, or S&P 500 Index, and the Bloomberg REIT Mortgage Index, or BBG REIT index, an industry index of mortgage REITs. The comparison is for the period from December 31, 2002 to December 31, 2007 and assumes the reinvestment of dividends. The graph and table assume that \$100 was invested in the Company’s Common Stock and the two other indices on December 31, 2002. Upon written request we will provide stockholders with a list of the REITs included in the BBG REIT Index.



	12/31/2002	12/31/2003	12/31/2004	12/31/2005	12/29/2006	12/31/2007
Annaly Capital Management, Inc.	100	108	116	68	122	127
S&P 500 Index	100	128	111	105	115	111
BBG Reit Index	100	117	116	161	175	48

The information in the share performance graph and table has been obtained from sources believed to be reliable, but neither its accuracy nor its completeness can be guaranteed. The historical information set forth above is not necessarily indicative of future performance. Accordingly, the Company does not make or endorse any predictions as to future share performance.

The share performance graph and table shall not be deemed, under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, to be (i) “soliciting material” or “filed” or (ii) incorporated by reference by any general statement into any filing made by the Company with the Securities and Exchange Commission, except to the extent that the Company specifically incorporates such share performance graph and table by reference.

## 2. Mortgage-Backed Securities

The following tables present the Company's available-for-sale Mortgage-Backed Securities portfolio as of December 31, 2007 and 2006:

<b>December 31, 2007</b>				
<b>(dollars in thousands)</b>	<b>Federal Home Loan Mortgage Corporation</b>	<b>Federal National Mortgage Association</b>	<b>Government National Mortgage Association</b>	<b>Total Mortgage-Backed Securities</b>
Mortgage-Backed Securities, gross	\$19,789,792	\$32,155,740	\$367,066	\$52,312,598
Unamortized discount	(30,679)	(45,496)	(506)	(76,681)
Unamortized premium	136,780	266,357	2,678	405,815
Amortized cost	19,895,893	32,376,601	369,238	52,641,732
Gross unrealized gains	141,248	224,795	2,229	368,272
Gross unrealized losses	(52,623)	(75,949)	(1,904)	(130,476)
Estimated fair value	\$19,984,518	\$32,525,447	\$369,563	\$52,879,528
	<b>Amortized Cost</b>	<b>Gross Unrealized Gain</b>	<b>Gross Unrealized Loss</b>	<b>Estimated Fair Value</b>
Adjustable rate	\$15,361,031	\$96,310	(\$76,853)	\$15,380,488
Fixed rate	37,280,701	271,962	(53,623)	37,499,040
Total	\$52,641,732	\$368,272	(\$130,476)	\$52,879,528

<b>December 31, 2006</b>				
<b>(dollars in thousands)</b>	<b>Federal Home Loan Mortgage Corporation</b>	<b>Federal National Mortgage Association</b>	<b>Government National Mortgage Association</b>	<b>Total Mortgage-Backed Securities</b>
Mortgage-Backed Securities, gross	\$10,675,235	\$19,085,218	\$324,338	\$30,084,791
Unamortized discount	(21,332)	(56,517)	(204)	(78,053)
Unamortized premium	82,707	133,164	3,271	219,142
Amortized cost	10,736,610	19,161,865	327,405	30,225,880
Gross unrealized gains	35,174	74,498	366	110,038
Gross unrealized losses	(73,125)	(92,548)	(2,736)	(168,409)
Estimated fair value	\$10,698,659	\$19,143,815	\$325,035	\$30,167,509
	<b>Amortized Cost</b>	<b>Gross Unrealized Gain</b>	<b>Gross Unrealized Loss</b>	<b>Estimated Fair Value</b>
Adjustable rate	\$8,546,363	\$12,764	(\$61,483)	\$8,497,644
Fixed rate	21,679,517	97,274	(106,926)	21,669,865
Total	\$30,225,880	\$110,038	(\$168,409)	\$30,167,509

Actual maturities of Mortgage-Backed Securities are generally shorter than stated contractual maturities. Actual maturities of the Company's Mortgage-Backed Securities are affected by the contractual lives of the underlying mortgages, periodic payments of principal, and prepayments of principal.

The following table summarizes the Company's mortgage-backed securities on December 31, 2007 and 2006, according to their estimated weighted-average life classifications:

<b>Weighted-Average Life (dollars in thousands)</b>	<b>December 31, 2007</b>		<b>December 31, 2006</b>	
	<b>Fair Value</b>	<b>Amortized Cost</b>	<b>Fair Value</b>	<b>Amortized Cost</b>
Less than one year	\$ 324,495	\$ 326,754	\$ 379,967	\$ 382,268
Greater than one year and less than five years	35,772,813	35,586,721	21,788,975	21,851,659
Greater than or equal to five years	16,782,220	16,728,257	7,998,567	7,991,953
Total	\$52,879,528	\$52,641,732	\$30,167,509	\$30,225,880

The weighted-average lives of the mortgage-backed securities at December 31, 2007 and 2006 in the table above are based upon data provided through subscription-based financial information services, assuming constant principal prepayment rates to the reset date of each security. The prepayment model considers current yield, forward yield, steepness of the yield curve, current mortgage rates, mortgage rate of the outstanding loans, loan age, margin and volatility.



The following table presents the gross unrealized losses, and estimated fair value of the Company's Mortgage-Backed Securities by length of time that such securities have been in a continuous unrealized loss position at December 31, 2007 and December 31, 2006.

(dollars in thousands)	Unrealized Loss Position for					
	Less than 12 Months		12 Months or More		Total	
	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
December 31, 2007	\$7,593,443	(\$62,594)	\$5,340,667	(\$67,882)	\$12,934,110	(\$130,476)
December 31, 2006	\$6,324,266	(\$30,244)	\$6,817,667	(\$138,165)	\$13,141,933	(\$168,409)

The decline in value of these securities is solely due to market conditions and not the quality of the assets. All of the Mortgage-Backed Securities are "AAA" rated or carry an implied "AAA" rating. The investments are not considered other-than-temporarily impaired because the Company currently has the ability and intent to hold the investments to maturity or for a period of time sufficient for a forecasted market price recovery up to or beyond the cost of the investments. Also, the Company is guaranteed payment of the principal amount of the securities.

The adjustable rate Mortgage-Backed Securities are limited by periodic caps (generally interest rate adjustments are limited to no more than 1% every nine months) and lifetime caps. The weighted average lifetime cap was 9.9% at December 31, 2007 and 9.8% at December 31, 2006.

During the year ended December 31, 2007, the Company realized \$19.1 million in net gains from sales of Investment Securities. During the year ended December 31, 2006, the Company realized \$3.9 million in net losses from sales of Investment Securities.

### 3. Repurchase Agreements

The Company had outstanding \$46.0 billion and \$27.5 billion of repurchase agreements with weighted average borrowing rates of 4.76% and 5.14%, with the effect of interest rate swaps, and weighted average remaining maturities of 234 days and 125 days as of December 31, 2007 and December 31, 2006, respectively. Investment Securities pledged as collateral under these repurchase agreements had an estimated fair value of \$48.3 billion at December 31, 2007 and \$28.6 billion at December 31, 2006.

At December 31, 2007 and December 31, 2006, the repurchase agreements had the following remaining maturities:

(dollars in thousands)	December 31, 2007	December 31, 2006
Within 30 days	\$34,940,600	\$22,778,703
30 to 59 days	4,005,960	2,285,317
60 to 89 days	300,000	200,000
90 to 119 days	—	—
Over 120 days	6,800,000	2,250,000
Total	\$46,046,560	\$27,514,020

The Company did not have an amount at risk greater than 10% of the equity of the Company with any counterparties as of December 31, 2007 or December 31, 2006.

The Company has entered into repurchase agreements which provide the counterparty with the right to call the balance prior to maturity date. The repurchase agreements totaled \$6.4 billion and the market value of the option to call is \$176.7 million. Management has determined that the call option is not required to be bifurcated under the provisions of FASB No. 133 as it is deemed clearly and closely related to the debt instrument, therefore the option value is not recorded in the consolidated financial statements.

The current situation in the sub-prime mortgage sector, and the current weakness in the broader mortgage market, could adversely affect one or more of the Company's lenders and could cause one or more of the Company's lenders to be unwilling or unable to provide it with additional financing. This could potentially increase the Company's financing costs and reduce liquidity. If one or more major market participants fails, it could negatively impact the marketability of all fixed income securities, including government mortgage securities, and this could negatively impact the value of the securities in the Company's portfolio, thus reducing its net book value. Furthermore, if many of the Company's lenders are unwilling or unable to provide it with additional financing, the Company could be forced to sell our Investment Securities at an inopportune time when prices are depressed. Even with the current situation in the sub-prime mortgage sector, the Company does not anticipate having difficulty converting its assets to cash or extending financing term, due to the fact that its Investment Securities have an actual or implied "AAA" rating and principal payment is guaranteed.

### 4. Interest Rate Swaps

In connection with the Company's interest rate risk management strategy, the Company hedges a portion of its interest rate risk by entering into derivative financial instrument contracts. As of December 31, 2007, such instruments are comprised of interest rate swaps, which in effect modify the cash flows on repurchase agreements. The use of interest rate swaps creates exposure to credit risk relating to potential losses that could be recognized if the counterparties to these instruments fail to perform their obligations under the contracts. In the event of a default by the counterparty, the Company could have difficulty obtaining its Mortgage-Backed Securities pledged as collateral for swaps. The Company does not anticipate any defaults by its counterparties.

The Company's swaps are used to lock-in the fixed rate related to a portion of its current and anticipated future 30-day term repurchase agreements.

The table below presents information about the Company's swaps outstanding at December 31, 2007.

(dollars in thousands)	Notional Amount	Weighted Average Pay Rate	Weighted Average Receive Rate	Net Estimated Fair Value Carrying Value
2007	\$16,243,500	5.03%	5.06%	(\$398,096)
2006	\$9,328,400	5.17%	5.35%	(\$17,621)

During the year ended December 31, 2007, the Company had a \$2.1 million realized gain on the termination of interest rate swaps with a notional value of \$900 million. During the year ended December 31, 2006, the Company had a \$10.7 million gain on the termination of interest rate swaps with a notional value of \$1.2 billion.

## 5. Preferred Stock and Common Stock

### (A) Stock Issuances

On October 11, 2007, the Company entered into an underwriting agreement pursuant to which it sold 71,300,000 shares of its common stock for net proceeds following underwriting expenses of approximately \$1.0 billion. This transaction settled on October 17, 2007.

On July 12, 2007, the Company entered into an underwriting agreement pursuant to which it sold 54,050,000 shares of its common stock for proceeds of \$720.8 million net of underwriting fees. This transaction settled on July 18, 2007.

On March 7, 2007, the Company entered into an underwriting agreement pursuant to which it sold 57,500,000 shares of its common stock for net proceeds following underwriting expenses of approximately \$737.4 million. This transaction settled on March 13, 2007.

During the year ended December 31, 2007, the Company raised \$116.5 million by issuing 8.0 million shares through the Direct Purchase and Dividend Reinvestment Program.

During the year ended December 31, 2007, 55,738 options were exercised under the Long-Term Stock Incentive Plan, or Incentive Plan, for an aggregate exercise price of \$576,000.

On August 3, 2006, the Company entered into an ATM Equity Offering<sup>sm</sup> Sales Agreement with Merrill Lynch & Co. and Merrill Lynch, Pierce, Fenner & Smith Incorporated, relating to the sale of shares of its common stock from time to time through Merrill Lynch. Sales of the shares, if any, are made by means of ordinary brokers' transaction on the New York Stock Exchange. During the year ended December 31, 2007, 4.5 million shares of our common stock were issued pursuant to this program, totaling \$66.2 million in net proceeds.

On August 3, 2006, the Company entered into an ATM Equity Sales Agreement with UBS Securities LLC, relating to the sale of shares of our common stock from time to time through UBS Securities. Sales of the shares, if any, will be made by means of ordinary brokers' transaction on the New York Stock Exchange. During the year ended December 31, 2007, 1.1 million shares of its common stock were issued pursuant to this program, totaling \$14.7 million in net proceeds.

On August 16, 2006, the Company entered into an underwriting agreement pursuant to which it sold 40,825,000 shares of its common stock for net proceeds before expenses of approximately \$476.7 million. This transaction settled on August 22, 2006.

On April 6, 2006, the Company entered into an underwriting agreement pursuant to which it sold 39,215,000 shares of its common stock for net proceeds before expenses of approximately \$437.7 million. On April 6, 2006, the Company entered into a second underwriting agreement pursuant to which it sold 4,600,000 shares of its 6% Series B Cumulative Convertible Preferred Stock for net proceeds before expenses of approximately \$111.5 million. Both of these transactions settled on April 12, 2006.

During the year ended December 31, 2006, 22,160 options were exercised under the long-term compensation plan for an aggregate exercise price of \$183,000.

During the year ended December 31, 2006, 500,000 shares of the Company's common stock, with net proceeds of \$6.7 million, were issued pursuant to the Merrill ATM Program. During the year ended December 31, 2006, 1.1 million shares of the Company's common stock were issued through the Equity Shelf Program with UBS Securities, totaling net proceeds of \$14.2 million.

During the year ended December 31, 2007, the Company declared dividends to common shareholders totaling \$339.8 million or \$1.04 per share, of which \$136.6 million were paid on January 28, 2008. During the year ended December 31, 2007, the Company declared and paid dividends to Series A preferred shareholders totaling \$14.6 million or \$1.97 per share and Series B Preferred shareholders totaling \$6.9 million or \$1.50 per share.

During the year ended December 31, 2006, the Company declared dividends to common shareholders totaling \$102.6 million or \$.57 per share, of which \$39.0 million were paid on January 26, 2007. During the year ended December 31, 2006, the Company declared and paid dividends to Series A preferred shareholders totaling \$14.6 million or \$1.97 per share and Series B Preferred shareholders totaling \$5.0 million or \$1.08 per share.

During the year ended December 31, 2005, the Company declared dividends to common shareholders totaling \$127.1 million, or \$1.04 per share, and the Company declared and paid dividends to preferred shareholders totaling \$14.6 million or \$1.97 per share. During the year ended December 31, 2005, 2,381,550 shares of the Company's common stock were issued through the Equity Shelf Program, totaling net proceeds of \$40.1 million. During the year ended December 31, 2005, 16,128 options were exercised under the long-term compensation plan for an aggregate exercise price of \$253,000. In addition, 24,253 common shares were sold through the dividend reinvestment and direct purchase program for \$440,000 during the year ended December 31, 2005.

### (B) Preferred Stock

At December 31, 2007, the Company had issued and outstanding 7,412,500 shares of Series A Cumulative Redeemable Preferred

Stock, with a par value \$0.01 per share and a liquidation preference of \$25.00 per share plus accrued and unpaid dividends (whether or not declared). The Series A preferred stock must be paid a dividend at a rate of 7.875% per year on the \$25.00 liquidation preference before the common stock is entitled to receive any dividends. The Series A preferred stock is redeemable at \$25.00 per share plus accrued and unpaid dividends (whether or not declared) exclusively at the Company's option commencing on April 5, 2009 (subject to the Company's right under limited circumstances to redeem the Series A preferred stock earlier in order to preserve its qualification as a REIT). The Series A preferred stock is senior to the Company's common stock and is on parity with the Series B preferred stock with respect to dividends and distributions, including distributions upon liquidation, dissolution or winding up. The Series A preferred stock generally does not have any voting rights, except if the Company fails to pay dividends on the Series A preferred stock for six or more quarterly periods (whether or not consecutive). Under such circumstances, the Series A preferred stock, together with the Series B preferred stock, will be entitled to vote to elect two additional directors to the Board, until all unpaid dividends have been paid or declared and set apart for payment. In addition, certain material and adverse changes to the terms of the Series A preferred stock cannot be made without the affirmative vote of holders of at least two-thirds of the outstanding shares of Series A preferred stock and Series B preferred stock. Through December 31, 2007, the Company had declared and paid all required quarterly dividends on the Series A preferred stock.

At December 31, 2007, the Company had issued and outstanding 4,600,000 shares of Series B Cumulative Convertible Preferred Stock, with a par value \$0.01 per share and a liquidation preference of \$25.00 per share plus accrued and unpaid dividends (whether or not declared). The Series B preferred stock must be paid a dividend

at a rate of 6% per year on the \$25.00 liquidation preference before the common stock is entitled to receive any dividends.

The Series B preferred stock is not redeemable. The Series B preferred stock is convertible into shares of common stock at a conversion rate that adjusts from time to time upon the occurrence of certain events, including if the Company distributes to its common shareholders in any calendar quarter cash dividends in excess of \$0.11 per share. Initially, the conversion rate was 1.7730 shares of common shares per \$25 liquidation preference. Commencing April 5, 2011, the Company has the right in certain circumstances to convert each Series B preferred stock into a number of common shares based upon the then prevailing conversion rate. The Series B preferred stock is also convertible into common shares at the option of the Series B preferred shareholder at any time at the then prevailing conversion rate. The Series B preferred stock is senior to the Company's common stock and is on parity with the Series A preferred stock with respect to dividends and distributions, including distributions upon liquidation, dissolution or winding up. The Series B preferred stock generally does not have any voting rights, except if the Company fails to pay dividends on the Series B preferred stock for six or more quarterly periods (whether or not consecutive). Under such circumstances, the Series B preferred stock, together with the Series A preferred stock, will be entitled to vote to elect two additional directors to the Board, until all unpaid dividends have been paid or declared and set apart for payment. In addition, certain material and adverse changes to the terms of the Series B preferred stock cannot be made without the affirmative vote of holders of at least two-thirds of the outstanding shares of Series B preferred stock and Series A preferred stock. Through December 31, 2007, the Company had declared and paid all required quarterly dividends on the Series B preferred stock.

## 6. Net Income (Loss) Per Common Share

The following table presents a reconciliation of the net income (loss) and shares used in calculating basic and diluted earnings per share for the years ended December 31, 2007, 2006 and 2005.

	December 31, 2007	For the years ended	
		December 31, 2006	December 31, 2005
Net income (loss)	\$414,384	\$93,816	(\$9,247)
Less: Preferred stock dividends	21,493	19,557	14,593
Net income available to common shareholders, prior to adjustment for Series B dividends, if necessary	392,891	74,259	(23,840)
Add: Preferred Series B dividends, if Series B shares are dilutive	6,900	—	—
Net income, as adjusted	399,791	74,259	(23,840)
Weighted average shares of common stock outstanding-basic	297,488	167,667	122,475
Add: Effect of dilutive stock options and Series B Cumulative Convertible Preferred Stock	8,775	79	—
Weighted average shares of common stock outstanding-diluted	306,263	167,746	122,475

The Series B Cumulative Convertible Preferred Stock was anti-dilutive for the years ended December 31, 2006 and 2005. Because the Company had a net loss related to common shareholders for the year ended December 31, 2005, options to purchase 2,333,593 shares of common stock were considered anti-dilutive for the year ended December 31, 2005.

## 7. Long-Term Stock Incentive Plan

The Company has adopted a long term stock incentive plan for executive officers, key employees and non-employee directors (the "Incentive Plan"). The Incentive Plan authorizes the Compensation Committee of the board of directors to grant awards, including non-qualified options as well as incentive stock options as defined

under Section 422 of the Code. The Incentive Plan authorizes the granting of options or other awards for an aggregate of the greater of 500,000 shares or 9.5% of the diluted outstanding shares of the Company's common stock, up to ceiling of 8,932,921 shares. Stock

options are issued at the current market price on the date of grant, subject to an immediate or four year vesting in four equal installments with a contractual term of 5 or 10 years. The grant date fair value is calculated using the Black-Scholes option valuation model.

	December 31, 2007		For the years ended December 31, 2006		December 31, 2005	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Options outstanding at the beginning of year	2,984,995	\$15.10	2,333,593	\$16.10	1,645,721	\$15.66
Granted	687,250	15.69	737,250	11.72	737,750	17.08
Exercised	(55,738)	10.34	(22,160)	8.25	(16,128)	12.21
Forfeited	(174,240)	16.06	(60,000)	15.39	—	—
Expired	(5,000)	20.35	(3,688)	13.69	(33,750)	17.87
Options outstanding at the end of year	3,437,267	\$15.23	2,984,995	\$15.10	2,333,593	\$16.10
Options exercisable at the end of the year	1,286,004	\$14.98	1,298,496	\$15.28	831,906	\$13.84

The weighted average remaining contractual term was approximately 7.0 years for stock options outstanding and approximately 5.3 years for stock options exercisable as of December 31, 2007. As of December 31, 2007, there was approximately \$2.9 million of total unrecognized compensation cost related to nonvested share-based compensation awards. That cost is expected to be recognized over a weighted average period of 2.7 years.

During the year ended December 31, 2007, the Company granted 7,000 shares of restricted common stock to certain of its employees. As of December 31, 2007, 5,250 of these restricted shares were unvested and subject to forfeiture.

The following table summarizes information about stock options outstanding at December 31, 2007:

Range of Exercise Prices	Total Options Outstanding	Weighted Average Exercise Price on Total Outstanding	Weighted Average Remaining Contractual Life (Years) on Total Outstanding	Total Options Exercisable	Weighted Average Exercise Price on Exercisable	Weighted Average Remaining Contractual Life (Years) on Exercisable
\$7.94-\$19.99	3,432,267	\$15.23	7.0	1,286,004	\$14.98	5.3
\$20.00-\$29.99	5,000	20.70	0.5	5,000	20.70	0.5
	3,437,267	\$15.23	7.0	1,291,004	\$15.00	5.3

## 8. Income Taxes

As a REIT, the Company is not subject to Federal income tax on earnings distributed to its shareholders. Most states recognize REIT status as well. The Company has decided to distribute the majority of its income and retain a portion of the permanent difference between book and taxable income arising from Section 162(m) of the Code pertaining to employee remuneration.

During the year ended December 31, 2007, the Company did not record income tax expense for income attributable to FIDAC, its taxable REIT subsidiary, and the portion of earnings retained based on Code Section 162(m) limitations. During the year ended December 31, 2007, the Company recorded \$9.0 million of income tax expense for a portion of earnings retained based on Section 162(m) limitations. The effective tax rate was 51% for the year ended December 31, 2007.

During the year ended December 31, 2006, the Company recorded \$3.1 million of income tax expense for income attributable to FIDAC, its taxable REIT subsidiary, and the portion of earnings retained based on Code Section 162(m) limitations. During the year ended December 31, 2006, the Company recorded \$4.5 million of income tax expense for a portion of earnings retained based on Section 162(m) limitations. The effective tax rate was 45% for the year ended December 31, 2006.

During the year ended December 31, 2005, the Company recorded \$8.7 million of income tax expense for income attributable to FIDAC and the portion of earnings retained based on Code Section 162(m) limitations. The Company's effective tax rate was 47% for the year ended December 31, 2005.

The Company's effective tax rate was 51%, 45%, and 47% for the year ended December 31, 2007, 2006, and 2005, respectively. These rates differed from the federal statutory rate as a result of state and local taxes and permanent difference pertaining to employee remuneration as discussed above.

## 9. Lease Commitments

The Company has a noncancelable lease for office space, which commenced in May 2002 and expires in December 2009. Gross office rent expense was \$725,000, \$618,000, and \$573,000 for the years ended December 31, 2007, 2006 and 2005, respectively. The gross expense was offset by sub-lease payments received of \$96,000, \$91,000, and \$84,000 for the years ended December 31, 2007, 2006 and 2005, respectively.

The Company's aggregate future minimum lease payments are \$532,000 in 2008 and in 2009.

## 10. Interest Rate Risk

The primary market risk to the Company is interest rate risk. Interest rates are highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political considerations and other factors beyond the Company's control. Changes in the general level of interest rates can affect net interest income, which is the difference between the interest bearing liabilities, by affecting the spread between the interest earning assets and interest-bearing liabilities. Changes in the level of interest rates also can affect the value of the Investment Securities and the Company's ability to realize gains from the sale of these assets. A decline in the value of the Investment Securities pledged as collateral for borrowings under repurchase agreements could result in the counterparties demanding additional collateral pledges or liquidation of some of the existing collateral to borrowing levels. Liquidation of collateral at losses could have an adverse accounting impact, as discussed in Note 3.

The Company seeks to manage the extent to which net income changes as a function of changes in interest rates by matching adjustable-rate assets with variable-rate borrowings. The Company may seek to mitigate the potential impact on net income of periodic and lifetime coupon adjustment restrictions in the portfolio of Investment Securities by entering into interest rate agreements such as interest rate caps and interest rate swaps. As of December 31, 2007, the Company

entered into interest rate swaps to pay a fixed rate and receive a floating rate of interest, with total notional amount of \$16.2 billion.

Changes in interest rates may also have an effect on the rate of mortgage principal prepayments and, as a result, prepayments on Mortgage-Backed Securities. The Company will seek to mitigate the effect of changes in the mortgage principal repayment rate by balancing assets purchased at a premium with assets purchased at a discount. To date, the aggregate premium exceeds the aggregate discount on the Mortgage-Backed Securities. As a result, prepayments, which result in the expensing of unamortized premium, will reduce net income compared to what net income would be absent such prepayments.

## 11. Commitments And Contingencies

From time to time, the Company is involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material effect on the Company's consolidated financial statements.

## 12. Subsequent Events

On January 23, 2008, the Company entered into an underwriting agreement pursuant to which it sold 58,650,000 shares of its common stock for net proceeds following underwriting expenses of approximately \$1.1 billion. This transaction settled on January 29, 2008.

## 13. Summarized Quarterly Results (Unaudited)

The following is a presentation of the quarterly results of operations for the year ended December 31, 2007.

(dollars in thousands, except per share data)

	March 31, 2007	June 30, 2007	September 30, 2007	December 31, 2007
Interest income	\$449,564	\$556,262	\$628,696	\$720,925
Interest expense	380,164	468,748	519,118	558,435
Net interest income	69,400	87,514	109,578	162,490
Other income:				
Investment advisory and service fees	5,562	5,366	5,464	5,636
Gain on sale of Investment Securities	6,145	7,293	3,795	1,829
Gain on termination of interest rate swaps	67	—	2,029	—
Income from trading securities	3,429	243	8,288	7,187
Dividend income from available-for-sale equity securities				91
Loss on other-than-temporarily impaired securities	(491)	(698)	—	—
Total other income	14,712	12,204	19,576	14,743
Expenses:				
Distribution fees	904	861	1,100	782
General and administrative expenses	12,886	12,272	17,334	20,174
Total expenses	13,790	13,133	18,434	20,956
Income before income taxes and minority interest	70,322	86,585	110,720	156,277
Income taxes	2,604	839	2,327	3,100
Income before minority interest	67,718	85,746	108,393	153,177
Minority interest	286	13	106	245
Net Income	67,432	85,733	108,287	152,932
Dividends on preferred stock	5,373	5,373	5,373	5,374
Net income available to common shareholders	\$62,059	\$80,360	\$102,914	\$147,558
Weighted average number of basic common shares outstanding	217,490,205	264,990,422	315,969,814	389,410,812
Weighted average number of diluted common shares outstanding	225,928,127	273,578,836	324,614,534	398,247,632
Net income available to common shareholders per average common share:				
Basic	\$0.29	\$0.30	\$0.33	\$0.38
Diluted	\$0.28	\$0.30	\$0.32	\$0.37

The following is a presentation of the quarterly results of operations for the year ended December 31, 2006.

(dollars in thousands, except per share data)	March 31, 2006	June 30, 2006	September 30, 2006	December 31, 2006
Interest income	\$194,882	\$280,171	\$339,737	\$407,092
Interest expense	167,512	242,473	295,726	349,302
Net interest income	27,370	37,698	44,011	57,790
Other (loss) income:				
Investment advisory and service fees	6,997	5,210	4,966	5,178
(Loss) gain on sale of Investment Securities	(7,006)	(1,239)	(446)	4,829
Gain on termination of interest rate swaps	—	—	8,414	2,260
Income from trading securities	—	—	612	3,382
Loss on other-than-temporarily impaired securities	(26,730)	(20,114)	—	(5,504)
Total other (loss) income	(26,739)	(16,143)	13,546	10,145
Expenses:				
Distribution fees	1,170	755	724	795
General and administrative expenses	7,177	8,985	11,682	12,219
Total expenses	8,347	9,740	12,406	13,014
Impairment of intangible for customer relationships	1,148	1,345	—	—
(Loss) income before income taxes and minority interest	(8,864)	10,470	45,151	54,921
Income taxes	2,085	1,892	2,273	1,288
(Loss) income before minority interest	(10,949)	8,578	42,878	53,633
Minority interest	—	—	28	296
Net (loss) income	(10,949)	8,578	42,850	53,337
Dividends on preferred stock	3,648	5,163	5,373	5,373
Net (loss related) income available to common shareholders	(\$14,597)	\$3,415	\$37,477	\$47,964
Weighted average number of basic common shares outstanding	123,693,851	158,632,865	181,767,106	205,092,330
Weighted average number of diluted common shares outstanding	123,693,851	158,703,614	189,952,159	213,455,555
<b>Net (loss related) income available to common shareholders per average common share:</b>				
Basic	(\$0.12)	\$0.02	\$0.21	\$0.23
Diluted	(\$0.12)	\$0.02	\$0.20	\$0.23

## COMMON STOCK AND MARKET INFORMATION (UNAUDITED)

The following table sets forth, for the periods indicated, the high, low, and closing sales prices per share of our common stock as reported on the New York Stock Exchange composite tape and the cash dividends declared per share of our common stock.

	Stock Prices		
	High	Low	Close
First Quarter ended March 31, 2007	\$15.48	\$13.54	\$15.48
Second Quarter ended June 30, 2007	\$16.20	\$13.83	\$14.42
Third Quarter ended September 30, 2007	\$16.42	\$13.03	\$15.93
Fourth Quarter ended December 31, 2007	\$18.18	\$15.25	\$18.18
	High	Low	Close
First Quarter ended March 31, 2006	\$12.82	\$11.34	\$12.14
Second Quarter ended June 30, 2006	\$14.04	\$11.57	\$12.81
Third Quarter ended September 30, 2006	\$13.25	\$12.17	\$13.14
Fourth Quarter ended December 31, 2006	\$14.42	\$13.01	\$13.91
	Common Dividends Declared Per Share		
First Quarter ended March 31, 2007	\$0.20		
Second Quarter ended June 30, 2007	\$0.24		
Third Quarter ended September 30, 2007	\$0.26		
Fourth Quarter ended December 31, 2007	\$0.34		
First Quarter ended March 31, 2006	\$0.11		
Second Quarter ended June 30, 2006	\$0.13		
Third Quarter ended September 30, 2006	\$0.14		
Fourth Quarter ended December 31, 2006	\$0.19		

We intend to pay quarterly dividends and to distribute to our stockholders all or substantially all of our taxable income in each year (subject to certain adjustments). This will enable us to qualify for the tax benefits accorded to a REIT under the Code. We have not established a minimum dividend payment level and our ability to pay dividends may be adversely affected for the reasons described under the caption "Risk Factors." All distributions will be made at the discretion of our board of directors and will depend on our earnings, our financial condition, maintenance of our REIT status and such other factors as our board of directors may deem relevant from time to time. No dividends can be paid on our common stock unless we have paid full cumulative dividends on our preferred stock. From the date of issuance of our preferred stock through December 31, 2007, we have paid full cumulative dividends on our preferred stock.

**CORPORATE OFFICERS**

**Michael A. J. Farrell**  
Chairman of the Board,  
President &  
Chief Executive Officer

**Wellington J. Denahan-Norris**  
Vice Chairman,  
Chief Investment Officer &  
Chief Operating Officer

**Kathryn F. Fagan**  
Chief Financial Officer &  
Treasurer

**R. Nicholas Singh**  
Executive Vice President,  
General Counsel, Secretary &  
Chief Compliance Officer

**James P. Fortescue**  
Executive Vice President  
Head of Liabilities

**Kristopher Konrad**  
Executive Vice President  
Co-Head of Portfolio Management

**Rose-Marie Lyght**  
Executive Vice President  
Co-Head of Portfolio Management

**Jeremy Diamond**  
Managing Director

**Ronald D. Kazel**  
Managing Director

**BOARD OF DIRECTORS**

**Michael A. J. Farrell**  
Chairman of the Board,  
President &  
Chief Executive Officer

**Wellington J. Denahan-Norris**  
Vice Chairman,  
Chief Investment Officer &  
Chief Operating Officer

**Kevin P. Brady**  
General Manager  
Thomson Corporation

**Jonathan D. Green**  
President & Chief Executive Officer  
Rockefeller Group International, Inc.

**John A. Lambiase**  
Former Managing Director  
Salomon Brothers, Inc.

**E. Wayne Nordberg**  
Chairman & Chief Executive Officer  
Hollow Brook Associates, LLC

**Donnell A. Segalas**  
Managing Partner &  
Chief Executive Officer  
Pinnacle Asset Management, L.P.

**CORPORATE HEADQUARTERS**

**Annaly Capital Management, Inc.**  
1211 Avenue of the Americas, Suite 2902  
New York, NY 10036

**LEGAL COUNSEL**

**Kirkpatrick & Lockhart Preston  
Gates Ellis LLP**  
1601 K. Street, N.W.  
Washington, D.C. 20006

**INDEPENDENT REGISTERED PUBLIC  
ACCOUNTING FIRM**

**Deloitte & Touche LLP**  
Two World Financial Center  
New York, NY 10281-1434

**STOCK TRANSFER AGENT**

Shareholder inquiries concerning dividend payments, lost certificates, change of address:  
**BNY Mellon Shareowner Services**  
480 Washington Blvd  
Jersey City, NJ 07310-1900  
800-301-5234  
[www.bnymellon.com/shareowner/isd](http://www.bnymellon.com/shareowner/isd)

**STOCK EXCHANGE LISTING**

The common stock is listed on the New York Stock Exchange (symbol: NLY).  
The Series A preferred stock is listed on the New York Stock Exchange (symbol: NLY-A).

**ANNUAL SHAREHOLDERS MEETING**

The Annual Meeting will be held Tuesday, May 20, 2008 at 9:00 a.m. at:  
**New York Marriott Marquis**  
1535 Broadway  
New York, NY 10036

**SHAREHOLDER COMMUNICATIONS**

Copies of the Company's Annual Report and 2007 Form 10-K may be obtained by writing the Secretary, by calling the investor relations hot line at 1-888-8annaly, or by visiting our website [www.annaly.com](http://www.annaly.com)

**ADDITIONAL INFORMATION**

The Company has included as exhibits to its annual report on Form 10-K for fiscal year ended 2007 certificates of the Company's Chief Executive Officer and Chief Financial Officer certifying the quality of the Company's public disclosure controls, and the Company has submitted to the New York Stock Exchange (NYSE) in 2007, a certificate of the Company's Chief Executive Officer certifying that he is not aware of any violations by the Company of the NYSE corporate governance listing standards.

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