

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

ANNALY CAPITAL MANAGEMENT INC
Form 10-Q
May 10, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED: MARCH 31, 2007

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM _____ TO _____

COMMISSION FILE NUMBER: 1-13447

ANNALY CAPITAL MANAGEMENT, INC.
(Exact name of Registrant as specified in its Charter)

MARYLAND
(State or other jurisdiction of
incorporation or organization)

22-3479661
(IRS Employer Identification No.)

1211 AVENUE OF THE AMERICAS, SUITE 2902
NEW YORK, NEW YORK
(Address of principal executive offices)

10036
(Zip Code)

(212) 696-0100
(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all documents and reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days:

Yes X No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the last practicable date:

Class	Outstanding at May 10, 2007
Common Stock, \$.01 par value	262,887,516

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

FORM 10-Q

TABLE OF CONTENTS

Part I. FINANCIAL INFORMATION

Item 1. Financial Statements:

Consolidated Statements of Financial Condition at March 31, 2007 (Unaudited) and December 31, 2006 (Derived from the audited consolidated financial statement at December 31, 2006)

Consolidated Statements of Operations and Comprehensive Income (Loss) (Unaudited) for the quarters ended March 31, 2007 and 2006

Consolidated Statement of Stockholders' Equity (Unaudited) for the quarter ended March 31, 2007

Consolidated Statements of Cash Flows (Unaudited) for the quarters ended March 31, 2007 and 2006

Notes to Consolidated Financial Statements (Unaudited)

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Item 4. Controls and Procedures

Part II. OTHER INFORMATION

Item 1. Legal Proceedings

Item 1A. Risk Factors

Item 6. Exhibits

SIGNATURES

CERTIFICATIONS

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION (dollars in thousands, except for share data)

	(unaudited)	
	MARCH 31, 2007	DECEMBER 31, 2006(1)

ASSETS		

Cash and cash equivalents	\$ 96,610	\$ 91,782
Mortgage-Backed Securities, at fair value	39,176,227	30,167,509
Agency debentures, at fair value	54,421	49,500
Trading securities, at fair value	7,872	18,365
Receivable for Mortgage-Backed Securities sold	28,643	200,535
Accrued interest receivable	179,816	146,089
Receivable for advisory and service fees	2,949	3,178
Intangible for customer relationships, net	10,849	11,184
Goodwill	22,966	22,966
Interest rate swaps, at fair value	1,028	2,558
Other assets	3,138	2,314

Total assets	\$ 39,584,519	\$ 30,715,980
=====		
LIABILITIES AND STOCKHOLDERS' EQUITY		

Liabilities:		
Repurchase agreements	\$ 33,348,011	\$ 27,514,020
Payable for Investment Securities purchased	2,590,429	338,172
Trading securities sold, not yet purchased, at fair value	39,679	41,948
Accrued interest payable	79,362	83,998
Dividends payable	52,577	39,016
Accounts payable	7,942	18,816
Interest rate swaps, at fair value	42,871	20,179

Total liabilities	36,160,871	28,056,149

Minority interest in equity of consolidated affiliate	5,610	5,324

6.00% Series B Cumulative Convertible Preferred Stock: 4,600,000 authorized, issued and outstanding	111,466	111,466

Stockholders' Equity:		
7.875% Series A Cumulative Redeemable Preferred Stock: 7,637,500 shares authorized, 7,412,500 shares issued and outstanding	177,088	177,088
Common stock: par value \$.01 per share; 487,762,500 shares authorized, 262,887,391 and 205,345,591 shares issued and outstanding, respectively	2,629	2,053
Additional paid-in capital	3,352,417	2,615,016
Accumulated other comprehensive loss	(60,040)	(76,112)
Accumulated deficit	(165,522)	(175,004)

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

Total stockholders' equity	3,306,572	2,543,041

Total liabilities, minority interest, Series B Cumulative Convertible		
Preferred Stock and stockholders' equity	\$ 39,584,519	\$ 30,715,980
=====		

(1) Derived from the audited consolidated financial statements at December 31, 2006.
See notes to consolidated financial statements.

1

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)
(UNAUDITED)
(dollars in thousands, except per share amounts)

	For the Quarter Ended March 31, 2007	For the Quarter Ended March 31, 2006
	-----	-----
Interest income	\$ 449,564	\$ 194,882
Interest expense	380,164	167,512
	-----	-----
Net interest income	69,400	27,370
	-----	-----
Other income (loss):		
Investment advisory and service fees	5,562	6,997
Gain (loss) on sale of Investment Securities	6,145	(7,006)
Gain on termination of interest rate swaps	67	-
Income from trading securities	3,429	-
Loss on other-than-temporarily impaired securities	(491)	(26,730)
	-----	-----
Total other income (loss)	14,712	(26,739)
	-----	-----
Expenses:		
Distribution fees	904	1,170
General and administrative expenses	12,886	7,177
	-----	-----
Total expenses	13,790	8,347
	-----	-----
Impairment of intangible for customer relationships	-	(1,148)
	-----	-----
Income (loss) before income taxes and minority interest	70,322	(8,864)
Income taxes	2,604	2,085
	-----	-----
Income (loss) before minority interest	67,718	(10,949)
Minority interest	286	-
	-----	-----
Net Income (loss)	67,432	(10,949)
Dividends on preferred stock	5,373	3,648
	-----	-----
Net income available (loss related) to common shareholders	\$ 62,059	(\$14,597)
	=====	=====

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

Net income available (loss related) to common shareholders per average common share:		
Basic	\$ 0.29	(\$0.12)
=====		
Diluted	\$ 0.28	(\$0.12)
=====		
Weighted average number of common shares outstanding:		
Basic	217,490,205	123,693,851
=====		
Diluted	225,928,127	123,693,851
=====		
Net income (loss)	\$ 67,432	(\$10,949)

Comprehensive income (loss):		
Unrealized gain (loss) on available-for sale securities	45,948	(113,091)
Unrealized (loss) gain on interest rate swaps	(24,155)	37,013
Reclassification adjustment for net (gains) losses included in net income or loss	(5,721)	33,736

Other comprehensive income (loss)	16,072	(42,342)

Comprehensive income (loss)	\$ 83,504	(\$53,291)
=====		

See notes to consolidated financial statements.

2

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
FOR THE QUARTER ENDED MARCH 31, 2007
(dollars in thousands, except per share data)
(UNAUDITED)

	Preferred Stock	Common Stock Par Value	Additional Paid-In Capital	Other Accumulated Comprehensive Income (Loss)
	-----	-----	-----	-----
BALANCE, JANUARY 1, 2007	\$ 177,088	\$ 2,053	\$ 2,615,016	(\$76,112)
Net income	-	-	-	-
Other comprehensive income	-	-	-	16,072
Comprehensive income	-	-	-	-
Exercise of stock options	-	-	417	-
Stock option expense	-	-	311	-
Net proceeds from follow-on offerings	-	576	736,673	-
Preferred Series A Cumulative Redeemable Preferred Stock dividends declared, \$0.492188 per share	-	-	-	-
Preferred Series B Cumulative Convertible Preferred Stock dividends declared, \$0.375 per share	-	-	-	-
Common dividends declared, \$0.20 per share	-	-	-	-

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

BALANCE, MARCH 31, 2007 \$ 177,088 \$ 2,629 \$ 3,352,417 (\$60,040)

See notes to consolidated financial statements.

3

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in thousands)
(UNAUDITED)

	For the Quarter Ended March 31, 2007	For the Quarter Ended March 31, 2006
Cash flows from operating activities:		
Net income (loss)	\$ 67,432	(\$10,949)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Amortization of Mortgage Backed Securities premiums and discounts, net	15,369	15,793
Amortization of intangibles	356	205
(Gain) loss on sale of Investment Securities	(6,145)	7,006
(Gain) on termination of interest rate swaps	(67)	-
Stock option expense	311	316
Net realized gain on trading investments	(670)	-
Unrealized appreciation on trading investments	(1,661)	-
Market value adjustment on long-term repurchase agreements	-	(148)
Loss on other-than-temporarily impaired securities	491	26,730
Impairment of intangibles	-	1,148
Increase in accrued interest receivable	(32,562)	(4,621)
Increase in other assets	(845)	(142)
Purchase of trading investments	(3,865)	-
Proceeds from sale of trading securities	4,566	-
Purchase of trading securities sold, not yet purchased	(7,831)	-
Proceeds for securities sold, not yet purchased	17,685	-
Decrease (increase) in advisory and service fees receivable	229	(308)
(Decrease) increase in interest payable	(4,636)	9,744
Decrease in accrued expenses and other liabilities	(10,874)	(5,600)
Net cash provided by operating activities	37,283	39,174
Cash flows from investing activities:		
Purchase of Mortgage-Backed Securities	(9,590,176)	(3,273,966)
Proceeds from termination of swaps	67	-
Proceeds from sale of Investment Securities	1,410,092	1,071,781
Principal receipts of Mortgage-Backed Securities	1,674,576	1,122,905
Purchase of agency debentures	(54,567)	-
Net cash used in investing activities	(6,560,008)	(1,079,280)
Cash flows from financing activities:		
Proceeds from repurchase agreements	97,057,073	52,762,754
Principal payments on repurchase agreements	(91,223,083)	(51,709,172)
Proceeds from exercise of stock options	417	136
Net proceeds from follow-on common stock offerings	737,249	-

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

Minority interest	286	-
Dividends paid	(44,389)	(16,017)
	-----	-----
Net cash provided by financing activities	6,527,553	1,037,701
	-----	-----
Net increase (decrease) in cash and cash equivalents	4,828	(2,405)
	-----	-----
Cash and cash equivalents, beginning of quarter	91,782	4,808
	-----	-----
Cash and cash equivalents, end of quarter	\$ 96,610	\$ 2,403
	=====	=====
Supplemental disclosure of cash flow information:		
Interest paid	\$ 384,800	\$ 177,256
	=====	=====
Taxes paid	\$ 2,476	\$ 2,339
	=====	=====
Noncash financing and investing activities:		
Net change in unrealized loss on available-for-sale securities and interest rate swaps, net of reclassification adjustment	\$ 16,072	(\$42,342)
	=====	=====
Dividends declared, not yet paid	\$ 52,577	\$ 13,607
	=====	=====

4

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 FOR THE QUARTER ENDED MARCH 31, 2007 AND 2006
 (UNAUDITED)

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 of 90% in an affiliated investment fund (the "Fund").

A summary of the Company's significant accounting policies follows:

Basis of Presentation - The accompanying unaudited consolidated financial statements have been prepared in conformity with the instructions to Form 10-Q and Article 10, Rule 10-01 of Regulation S-X for interim financial statements. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America ("GAAP"). The consolidated interim financial statements are unaudited; however, in the opinion of the Company's management, all adjustments, consisting only of normal recurring accruals, necessary for a fair statement of the financial positions, results of operations, and cash flows have been included. These unaudited consolidated financial statements should be read in conjunction with

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

the audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2006. The nature of the Company's business is such that the results of any interim period are not necessarily indicative of results for a full year.

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 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 deposit 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, ("SFAS 115") 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.

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

5

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 \$491,000 during the quarter ended March 31, 2007 and \$26.7 million during the quarter ended March 31, 2006.

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 fair value of Mortgage-Backed Securities and agency debentures available-for-sale and interest rate swaps is equal to their carrying value presented in the consolidated statements of financial condition. The fair value of trading securities and trading securities sold, not yet purchased, is equal to their estimated fair value. The fair value of cash and cash equivalents, accrued interest receivable, receivable for securities

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

sold, receivable for advisory and service fees, repurchase agreements, with less than a one year maturity date, and payable for Mortgage-Backed Securities purchased, dividends payable, accounts payable, and accrued interest payable, generally approximates cost as of March 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 significant uncertainties regarding the characteristics of the securities are removed, generally shortly before settlement date. Realized gains and losses on sale of Investment Securities are determined based on the specific identification basis.

Derivative Financial Instruments/Hedging Activity - The Company hedges interest rate risk through the use of derivative financial instruments such as 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 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 March 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 quarter. 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 and 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

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

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. For the quarter ended March 31, 2007, a gain of \$67,000 was recognized in earnings. There were no gains or losses recognized in earnings for the quarter ended March 31, 2006.

Credit Risk - The Company has limited its exposure to credit losses on its portfolio of Mortgage-Backed 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 included in the balance sheet as a result of consolidating the financial statements of the Fund, and are carried at fair value at March 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 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.

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

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 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.

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 an 8.7 year weighted average time period. During the quarter ended March 31, 2007, the Company recognized no impairment losses on intangible assets relating to customer relationships. During the quarter ended March 31, 2006, the Company recorded \$1.1 million in 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 No. 123R"). SFAS No. 123R, which replaced SFAS No. 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 No. 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). We estimate fair value using the Black-Scholes valuation model. There were no options granted during the quarter ended March 31, 2007.

Prior to the adoption of SFAS No. 123R, the Company used the intrinsic value method prescribed in APB 25 and also followed the disclosure requirements of SFAS No. 123, as amended by SFAS No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure ("SFAS No. 148") which required certain disclosures on a pro forma basis as if the fair value method had been followed for accounting for such compensation.

Recent Accounting Pronouncements- In February 2006, the FASB issued FAS No. 155, Accounting for Certain Hybrid Instruments ("FAS 155"), an amendment of FASB Statements No. 133 and 140. Among other things, FAS 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

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

interest-only strips and principal-only strips are not subject to the requirements of FAS 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 FAS 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. FAS 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 FAS 155 as a result of this scope exception. Therefore, 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 FAS 155 did not have any impact on the Company's financial position, results of operations or cash flows.

8

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 FASB Statement 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 from implementing this new standard.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. SFAS No. 157 defines fair value, establishes a framework for measuring fair value and requires enhanced disclosures about fair value measurements. SFAS No. 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 (which require significant management judgment), including a reconciliation of the beginning and ending balances separately for each major category of assets and liabilities. SFAS No. 157 is effective for the Company on January 1, 2008. The Company is currently evaluating the impact adoption of SFAS No. 157 may have on its consolidated financial statements.

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 FAS 159 is effective for the Company commencing January 1, 2008. The Company is currently evaluating the impact that the adoption of SFAS 159 will have on its consolidated financial statements.

Proposed Accounting Pronouncements- The FASB has added an item to its current proposed amendment relating to the accounting treatment under SFAS No.

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities of transactions where assets purchased from a particular counterparty are financed via a repurchase agreement with the same counterparty. Currently, the Company records such assets and the related financing 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 (loss) income. 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.

However, a transaction where assets are acquired from and financed under a repurchase agreement with the same counterparty may not qualify for a sale treatment by a seller under an interpretation of SFAS No. 140, which would require the seller to continue to carry such sold assets on their books based on their "continuing involvement" with such assets. Depending on the ultimate outcome of the FASB deliberations, the result may be that the Company would be precluded from recording the assets purchased in the transaction described above as well as the related financing in the Company's consolidated statement of financial condition and would instead be treating the Company's net investment in such assets as a derivative.

This potential change in accounting treatment would not affect the economic substance of the transactions but would affect how the transactions would be reported in the Company's financial statements. The Company's cash flows, liquidity and ability to pay a dividend would be unchanged, and the Company does not believe the Company's taxable income or net equity would be affected.

9

2. MORTGAGE-BACKED SECURITIES

The following tables present the Company's available-for-sale Mortgage-Backed Securities portfolio as of March 31, 2007 and December 31, 2006, which are carried at their fair value:

March 31, 2007	Federal Home Loan Mortgage Corporation	Federal National Association	Government National Mortgage Association	Total Backe
(dollars in thousands)				
Mortgage-Backed Securities, gross	\$ 14,176,906	\$ 24,455,227	\$ 366,063	\$
Unamortized discount	(26,689)	(68,845)	(182)	\$
Unamortized premium	102,538	186,144	3,116	\$
Amortized cost	14,252,755	24,572,526	368,997	\$
Gross unrealized gains	45,748	90,219	1,216	\$
Gross unrealized losses	(65,342)	(87,724)	(2,168)	\$
Estimated fair value	\$ 14,233,161	\$ 24,575,021	\$ 368,045	\$
	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Estimat
Adjustable rate	\$ 9,715,401	\$ 12,875	(\$ 51,472)	\$

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

Fixed rate	29,478,877	124,308	(103,762)	
Total	\$ 39,194,278	\$ 137,183	(\$155,234)	\$
December 31, 2006	Federal Home Loan Mortgage Corporation	Federal National Mortgage Association	Government National Mortgage Association	Total Backe
	(dollars in thousands)			
Mortgage-Backed Securities, gross	\$ 10,675,235	\$ 19,085,218	\$ 324,338	\$
Unamortized discount	(21,332)	(56,517)	(204)	
Unamortized premium	82,707	133,164	3,271	
Amortized cost	10,736,610	19,161,865	327,405	
Gross unrealized gains	35,174	74,498	366	
Gross unrealized losses	(73,125)	(92,548)	(2,736)	
Estimated fair value	\$ 10,698,659	\$ 19,143,815	\$ 325,035	\$
	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Estimat
Adjustable rate	\$ 8,546,363	\$ 12,764	(\$61,483)	\$
Fixed rate	21,679,517	97,274	(106,926)	
Total	\$ 30,225,880	\$ 110,038	(\$168,409)	\$

10

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 March 31, 2007 and December 31, 2006 according to their estimated weighted-average life classifications:

Weighted-Average Life	March 31, 2007		December 31, 2006	
	Fair Value	Amortized Cost	Fair Value	Amortized Cost
	(dollars in thousands)			
Less than one year	\$ 310,231	\$ 312,992	\$ 379,967	\$ 382,2
Greater than one year and less than five years	26,318,717	26,332,253	21,788,975	21,851,6
Greater than or equal to five years	12,547,279	12,549,033	7,998,567	7,991,9
Total	\$ 39,176,227	\$ 39,194,278	\$ 30,167,509	\$ 30,225,8

=====

The weighted-average lives of the Mortgage-Backed Securities at March 31, 2007 and December 31, 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.

Mortgage-Backed Securities with a carrying value of \$8.3 billion were in a continuous unrealized loss position over 12 months at March 31, 2007 in the amount of \$125.8 million. Mortgage-Backed Securities with a carrying value of \$11.2 billion were in a continuous unrealized loss position for less than 12 months at March 31, 2007 in the amount of \$29.5 million. Mortgage-Backed Securities with a carrying value of \$7.0 billion were in a continuous unrealized loss position over 12 months at December 31, 2006 in the amount of \$138.2 million. Mortgage-Backed Securities with a carrying value of \$6.4 billion were in a continuous unrealized loss position for less than 12 months at December 31, 2006 in the amount of \$30.2 million. The decline in value of these securities is solely due to increases in interest rates. All of the Mortgage-Backed Securities are "AAA" rated or carry an implied "AAA" rating. During the quarters ended March 31, 2007 and 2006, the Company recorded impairment losses of \$491,000 and \$26.7 million, respectively. The remaining investments are not considered other-than-temporarily impaired since 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 on the par value 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 10.0% at March 31, 2007 and 9.8% at December 31, 2006.

During the quarter ended March 31, 2007 the Company realized \$6.1 million in net gain from sales of Investment Securities. During the quarter ended March 31, 2006, the Company realized \$7.0 million in net losses from sales of Mortgage-Backed Securities.

3. AGENCY DEBENTURES

At March 31, 2007, the Company owned agency debentures with a carrying value of \$54.4 million, including the unrealized loss of \$146,000. At December 31, 2006, the Company owned agency debentures with a carrying value of \$49.5 million, including the unrealized loss of \$120,000.

4. REPURCHASE AGREEMENTS

The Company had outstanding \$33.3 billion and \$27.5 billion of repurchase agreements with weighted average borrowing rates of 5.17% and 5.14%, and weighted average remaining maturities of 200 days and 125 days as of March 31, 2007 and December 31, 2006, respectively. Investment Securities pledged as collateral under these repurchase agreements had an estimated fair value of \$35.5 billion at March 31, 2007 and \$28.6 billion at December 31, 2006.

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

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

	March 31, 2007	December 31, 2006
	(dollars in thousands)	
Within 30 days	\$ 25,337,550	\$ 22,778,703
30 to 59 days	4,660,461	2,285,317
60 to 89 days	300,000	200,000
90 to 119 days	-	-
Over 120 days	3,050,000	2,250,000
Total	\$ 33,348,011	\$ 27,514,020

The Company did not have an amount at risk greater than 10% of the equity of the Company with any individual counterparty as of March 31, 2007.

The Company had an amount at risk greater than 10% of the equity of the Company with the following counterparty at December 31, 2006.

	Amount at risk(1) (dollars in thousands)	Weighted average days to maturity
UBS Securities LLC	\$179,959	121

(1) Equal to the sum of fair value of securities sold plus accrued interest income minus the sum of repurchase agreements plus accrued interest expense.

As of March 31, 2007, 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 \$2.5 billion and the market value of the option to call is a negative \$2.5 million. Management has determined that the call option is not required to be bifurcated under the provisions of SFAS 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.

5. 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 March 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 March 31, 2007.

Notional Amount (dollars in thousands)	Weighted Average Pay Rate	Weighted Average Receive Rate	Net Estimated Fair Value/Carrying Value (dollars in thousands)
\$13,235,400	5.10%	5.32%	(\$41,843)

6. PREFERRED STOCK AND COMMON STOCK

(A) Common Stock Issuances

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

On August 3, 2006, the Company entered into an ATM Equity Offering(sm) 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, will be made by means of ordinary brokers' transaction on the New York Stock Exchange. During the quarter ended March 31, 2007, no shares of the Company's common stock were issued pursuant to this program.

On August 3, 2006, the Company entered into an ATM Equity Sales Agreement with UBS Securities LLC, relating to the sale of shares of its 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 quarter ended March 31, 2007, no shares of the Company's common stock were issued pursuant to this program.

(B) Preferred Stock

At March 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 stockholders 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 March 31, 2007, the Company had declared and paid all required quarterly dividends on the Series A preferred stock.

At March 31, 2007, the Company also 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 stockholders 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.

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

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 a 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 March 31, 2007, the Company had declared and paid all required quarterly dividends on the Series B preferred stock.

13

(C) Distributions to Shareholders

During the quarter ended March 31, 2007, the Company declared dividends to common shareholders totaling \$52.6 million or \$0.20 per share, which were paid on April 26, 2007. During the quarter ended March 31, 2006, the Company declared dividends to Series A Preferred shareholders totaling \$3.6 million or \$0.492188 per share, and Series B shareholders totaling \$1.7 million or \$0.375 per share, which were paid on April 2, 2006.

7. 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 quarters ended March 31, 2007 and 2006.

	For the Quarters Ended	
	March 31, 2007	March 31, 2006
Net income (loss)	\$ 67,432	(\$10,9
Less: Preferred stock dividends	5,373	3,6
Net income available (loss related) to common shareholders, prior to adjustment for Series B dividends, if necessary	62,059	(14,5
Add: Preferred Series B dividends, if Series B shares are dilutive	1,725	
Net income available (loss related) to common shareholders	\$ 63,784	(\$14,5

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

Weighted average shares of common stock outstanding-basic	217,490	123,6
Add: Effect of dilutive stock options	153	
Series B Cumulative Convertible Preferred Stock	8,285	
Weighted average shares of common stock outstanding-diluted	225,928	123,6

Options to purchase 1,795,375 shares of common stock were outstanding and considered anti-dilutive as their exercise price exceeded the average stock price for the quarter ended March 31, 2007. The Series B Cumulative Convertible Preferred Stock and options to purchase 3,047,868 shares of common stock were anti-dilutive for the quarter ended March 31, 2006, because the Company had a net loss related to common shareholders for the quarter ended March 31, 2006.

8. 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.

14

	For the quarters ended March 31, 2007		
	Number of Shares	Weighted Average Exercise Price	Number of Shares
Options outstanding at the beginning of quarter	2,984,995	\$ 15.10	2,333,5
Granted	-	-	731,0
Exercised	(41,800)	9.99	(16,7
Forfeited	(174,240)	16.06	
Options outstanding at the end of quarter	2,768,955	\$ 15.11	3,047,8
Options exercisable at the end of the quarter	1,298,692	\$ 14.98	831,1

The weighted average remaining contractual term was approximately 7.1 years for stock options outstanding and approximately 6.1 years for stock options exercisable as of March 31, 2007. As of March 31, 2006, there was approximately \$3.7 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 3.2 years.

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

The following table summarizes information about stock options outstanding at March 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	2,758,955	\$15.09	7.2	1,288,692	\$14.94	
\$20.00-\$29.99	10,000	20.53	0.7	10,000	20.53	
	2,768,955	\$15.11	7.1	1,298,692	\$14.98	

9. 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 quarter ended March 31, 2007, the Company recorded \$428,000 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 quarter ended March 31, 2007, the Company recorded approximately \$2.2 million of income tax expense for a portion of earnings retained based on Section 162(m) limitations. The statutory combined federal, state, and city corporate tax rate is 45%. This amount is applied to the amount of estimated REIT taxable income retained (if any, and only up to 10% of ordinary income as all capital gain income is distributed) and to taxable income earned at the taxable subsidiaries. Thus, as a REIT, our effective tax rate is significantly less as we are allowed to deduct dividend distributions.

During the quarter ended March 31, 2006, the Company recorded approximately \$1.6 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 quarter ended March 31, 2006, the Company recorded \$471,000 of income tax expense for a portion of earnings retained based on Section 162(m) limitations.

15

10. LEASE COMMITMENTS

The Company has a noncancelable lease for office space, which commenced in May 2002 and expires in December 2009. The Company's aggregate future minimum lease payments are as follows:

	Total per Year (dollars in thousands)
2007	\$399
2008	532

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

2009

532

Total remaining lease payments

\$1,463
=====

11. 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 income earned on interest-earning assets and the interest expense incurred in connection with 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 reduce borrowing levels. Liquidation of collateral at losses could have an adverse accounting impact.

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 March 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 \$13.2 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.

12. 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.

16

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Special Note Regarding Forward-Looking Statements

Certain statements contained in this quarterly report, and certain statements contained in our future filings with the Securities and Exchange Commission (the "SEC" or the "Commission"), in our press releases or in our other public or shareholder communications may not be based on historical facts and are "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements, which are based on various

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

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 financings, 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 governmental regulations affecting our business, and our ability to maintain our classification 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 our most recent Annual Report on Form 10-K and any 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 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

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

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.

17

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 17% and 18% for the quarters ended March 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 table below provides quarterly information regarding our average balances, interest income, interest expense, yield on assets, cost of funds and net interest income for the quarterly periods presented.

	Average Investment Securities Held (1)	Total Interest Income	Yield on Average Investment Securities	Average Repurchase Agreements	Interest Expense	Average Cost of Funds
----- (ratios for the quarters have been annualized, dollars in millions)						
Quarter Ended March 31, 2007	\$31,682,974	\$449,564	5.68%	\$29,834,208	\$380,164	5.0%
Quarter Ended December 31, 2006	\$28,888,956	\$407,092	5.64%	\$27,118,402	\$349,302	5.0%
Quarter Ended September 30, 2006	\$24,976,876	\$339,737	5.44%	\$23,120,247	\$295,726	5.0%
Quarter Ended June 30, 2006	\$21,660,089	\$280,171	5.17%	\$20,060,978	\$242,473	4.9%

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

March 31, 2006	\$16,590,859	\$194,882	4.70%	\$15,296,893	\$167,512	4.
----------------	--------------	-----------	-------	--------------	-----------	----

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

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

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

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

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

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. Other-than-temporary impaired losses on securities totaled \$491,000 for the quarter ended March 31, 2007 and \$26.7 million for the quarter ended March 31, 2006.

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.

19

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 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. Intangible assets are periodically reviewed for potential impairment. This evaluation requires significant judgment. During the quarter ended March 31, 2007 we recognized no impairment charges on intangible assets.

Results of Operations: For the Quarters Ended March 31, 2007 and 2006

Net Income Summary

For the quarter ended March 31, 2007, our net income was \$67.4 million, or \$0.29 basic net income per average share available to common shareholders, as compared to net loss of \$10.9 million, or \$0.12 net loss per average share available to common shareholders, for the quarter ended March 31, 2006. We attribute the increase in total net income for the quarter ended March 31, 2007 from the quarter ended March 31, 2006 to the increased asset base, the increase in interest rate spread, gains on sales of Mortgage-Backed Securities and the

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

termination of interest rate swaps, and a decline in loss on other-than-temporarily impaired securities. The increase in total net income per share was primarily due to the increase in the interest rate spread from 0.32% to 0.58%. The increase in yield on investment securities to 5.68% for the quarter ended March 31, 2007 from 4.70% for the quarter ended March 31, 2006 was only partially offset by the increase in cost of funding to 5.10% for the quarter ended March 31, 2007 from 4.38% for the quarter ended March 31, 2006. For the quarter ended March 31, 2007, net investment advisory and service fees totaled \$4.7 million, as compared to \$5.8 million for the quarter ended March 31, 2006. For the quarter ended March 31, 2007, the net gain on sale of Mortgage-Backed Securities and termination of interest rate swaps was \$6.2 million as compared to a \$7.0 million loss on sale of Mortgage-Backed Securities for the quarter ended March 31, 2006. Gross income from trading securities totaled \$3.4 million for the quarter ended March 31, 2007. There was no income from trading securities for the quarter ended March 31, 2006. For the quarter ended March 31, 2007, the loss on other-than-temporarily impaired securities totaled \$491,000, as compared to \$26.7 million for the quarter ended March 31, 2006. For the quarter ended March 31, 2007, general and administrative expenses totaled \$12.9 million, as compared to \$7.2 million for the quarter ended March 31, 2006.

Dividends for the quarter ended March 31, 2007 were \$0.20 per share of common stock, or \$52.6 million in total, and \$0.492188 per share of Series A preferred stock, or \$3.6 million in total, and \$0.375 per share of Series B preferred stock or \$1.7 million in total. Dividends per share for the quarter ended March 31, 2006 were \$0.11 per share of common stock, or \$13.6 million in total and \$0.492188 per share of Series A preferred stock, or \$3.6 million in total. The 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. Our return on average equity was 8.9% for the quarter ended March 31, 2007 compared to (2.98%) for the quarter ended March 31, 2006.

20

Net Income (Loss) Summary
(dollars in thousands, except for per share data)
(ratios for the quarters have been annualized)

	Quarter Ended March 31, 2007	Quarter Ended March 31, 2006
	-----	-----
Interest income	\$ 449,564	\$ 194,8
Interest expense	380,164	167,5
	-----	-----
Net interest income	69,400	27,3
	-----	-----
Other income (loss):		
Investment advisory and service fees	5,562	6,9
Gain (loss) on sale of investment securities	6,145	(7,0
Gain on termination of interest rate swaps	67	
Income from trading securities	3,429	
Loss on other-than-temporarily impaired securities	(491)	(26,7
	-----	-----
Total other income (loss)	14,712	(26,7
	-----	-----
Expenses:		
Distribution fees	904	1,1

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

General and administrative expenses	12,886	7,1
	13,790	8,3
Total expenses		
Impairment of intangible for customer relationships	-	(1,1
	67,322	(8,8
Income (loss) before income taxes and minority interest		
Income taxes	2,604	2,0
	67,718	(10,9
Income (loss) before minority interest		
Minority interest	286	
	67,432	(10,9
Net Income (loss)		
Dividends on preferred stock	5,373	3,6
	\$ 62,059	(\$14,5
Net income available (loss related) to common shareholders		
Weighted average number of basic common shares outstanding	217,490,205	123,693,8
Weighted average number of diluted common shares outstanding	225,928,127	123,693,8
Basic net income (loss) per average common share	\$ 0.29	(\$0.
Diluted net income (loss) per average common share	\$ 0.28	(\$0.
Average total assets	\$ 35,150,250	\$ 16,268,0
Average equity	\$ 3,036,273	\$ 1,468,9
Return on average total assets	0.77%	(0.2
Return on average equity	8.88%	(2.9

Interest Income and Average Earning Asset Yield

We had average earning assets of \$31.7 billion and \$16.6 billion for the quarters ended March 31, 2007 and 2006, respectively. Our primary source of income for the quarters ended March 31, 2007 and 2006 was interest income. Our interest income was \$449.6 million for the quarter ended March 31, 2007 and \$194.9 million for the quarter ended March 31, 2006. The yield on average investment securities increased by 98 basis points, from 4.70% for the quarter ended March 31, 2006 to 5.68%, for the quarter ended March 31, 2007. Our average investment securities increased by \$15.1 billion and interest income increased by \$254.7 million for the quarter ended March 31, 2007 as compared to the quarter ended March 31, 2006. The average coupon rate at March 31, 2007 was 5.84% as compared to 5.22% at March 31, 2006. The prepayment speeds decreased to 17% CPR for the quarter ended March 31, 2007 from 18% CPR for the quarter ended March 31, 2006. The increase in coupon rates and reduction in prepayment speeds resulted in an increase in yield.

21

Interest Expense and the Cost of Funds

Our largest expense is the cost of borrowed funds. We had average borrowed

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

funds of \$29.8 billion and total interest expense of \$380.2 million for the quarter ended March 31, 2007. We had average borrowed funds of \$15.3 billion and total interest expense of \$167.5 million for the quarter ended March 31, 2006. Our average cost of funds was 5.10% for the quarter ended March 31, 2007 and 4.38% for the quarter ended March 31, 2006. The cost of funds rate increased by 72 basis points and the average borrowed funds increased by \$14.5 billion for the quarter ended March 31, 2007 when compared to the quarter ended March 31, 2006. Interest expense for the quarter increased by \$212.7 million due to the substantial increase in the average repurchase balance and the increase in the cost of funds rate. 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 0.16% below average one-month LIBOR and 0.20% below average six-month LIBOR for the quarter ended March 31, 2007. Our average cost of funds was 0.17% below average one-month LIBOR and 0.46% below average six-month LIBOR for the quarter ended March 31, 2006.

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 quarter ended March 31, 2007, the year ended December 31, 2006 and the four quarters in 2006.

Average Cost of Funds
(ratios for the quarters have been annualized, dollars in thousands)

	Average Repurchase Agreements	Interest Expense	Average Cost of Funds	Average One- Month LIBOR	Average Six-Month LIBOR	Average One-Month LI Relative t Average Si Month LIBO
For the Quarter Ended March 31, 2007	\$ 29,834,208	\$ 380,164	5.10%	5.26%	5.30%	(0.04%)
For the Year Ended December 31, 2006	\$ 21,399,130	\$1,055,013	4.93%	5.03%	5.21%	(0.18%)
For the Quarter Ended December 31, 2006	\$ 27,118,402	\$ 349,302	5.15%	5.27%	5.31%	(0.04%)
For the Quarter Ended September 30, 2006	\$ 23,120,247	\$ 295,726	5.12%	5.29%	5.43%	(0.14%)
For the Quarter Ended June 30, 2006	\$ 20,060,978	\$ 242,473	4.83%	5.03%	5.27%	(0.24%)
For the Quarter Ended March 31, 2006	\$ 15,296,893	\$ 167,512	4.38%	4.55%	4.84%	(0.29%)

Net Interest Income

Our net interest income, which equals interest income less interest expense, totaled \$69.4 million for the quarter ended March 31, 2007 and \$27.4 million for the quarter ended March 31, 2006. Our net interest income increased because of the increase in average investment securities we owned and because of an increase in interest rate spread. Our net interest rate spread, which equals the yield on our average assets for the period less the average cost of funds for the period, was 0.58% for the quarter ended March 31, 2007 as compared to 0.32% for the quarter ended March 31, 2006. This 26 basis point increase was a result of the yield increasing for the quarter ended March 31, 2007 to 5.68% from 4.70% for the quarter ended March 31, 2006. The increase in yield was only partially offset by the increase in cost of funds, which increased to 5.10% for the quarter ended March 31, 2007, as compared to 4.38% for the quarter ended

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

March 31, 2006.

22

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 quarter ended March 31, 2007, the year ended December 31, 2006 and the four quarters in 2006.

Net Interest Income

(Ratios for the quarters have been annualized, dollars in thousands)

	Average Investment Securities Held(1)	Total Interest Income	Yield Average Interest Earning Assets	Average Balance of Repurchase Agreements	Interest Expense	Average Cost Funds
For the Quarter Ended March 31, 2007	\$ 31,682,974	\$ 449,564	5.68%	\$ 29,834,208	\$ 380,164	5.
For the Year Ended December 31, 2006	\$ 23,029,195	\$1,221,882	5.31%	\$ 21,399,130	\$1,055,013	4.
For the Quarter Ended December 31, 2006	\$ 28,888,956	\$ 407,092	5.64%	\$ 27,118,402	349,302	5.
For the Quarter Ended September 30, 2006	\$ 24,976,876	\$ 339,737	5.44%	\$ 23,120,247	\$ 295,726	5.
For the Quarter Ended June 30, 2006	\$ 21,660,089	\$ 280,171	5.17%	\$ 20,060,978	\$ 242,473	4.
For the Quarter Ended March 31, 2006	\$ 16,590,859	\$ 194,882	4.70%	\$ 15,296,893	\$ 167,512	4.

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

Investment Advisory and Service Fees

FIDAC is a registered investment advisor which specializes in managing fixed income securities. FIDAC expanded its line of business in 2006 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 of approximately 10 to 20 basis points of the gross assets it manages, assists in managing or supervises. At March 31, 2007, FIDAC had under management approximately \$2.5 billion in net assets and \$16.1 billion in gross assets, compared to \$2.0 billion in net assets and \$16.9 billion in gross assets at March 31, 2006. Investment advisory and service fees for the quarters ended March 31, 2007 and 2006 totaled \$4.7 million and \$5.8 million respectively, net of fees paid to third parties pursuant to distribution agreements for facilitating and promoting distribution of shares of 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 quarter ended March 31, 2007, we sold Mortgage-Backed Securities with a carrying value of \$1.2 billion for an aggregate gain of \$6.1 million and terminated interest rates swap agreements with a notional amount of \$300 million for a gain of \$67,000. For the quarter ended March 31, 2006, we sold

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

Mortgage-Backed Securities with a carrying value of \$1.2 billion for an aggregate loss of \$7.0 million.

Income from Trading Securities

Gross income from trading securities totaled \$3.4 million for the quarter ended March 31, 2007. During the quarter ended March 31, 2006, we did not earn income from trading securities.

Impairment of Intangible for Customer Relationships

During the quarter ended March 31, 2007, it was determined that there was no impairment of intangibles for customer relationships. The value of the intangible for customer relationships of \$1.1 million was deemed to be impaired during the quarter ended March 31, 2006.

23

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 quarter ended March 31, 2007 and 2006, the loss on other-than temporarily impaired securities totaled \$491,000 and \$26.7 million, respectively.

General and Administrative Expenses

General and administrative (or G&A) expenses were \$12.9 million for the quarter ended March 31, 2007, and \$7.2 million for the quarter ended March 31, 2006. G&A expenses as a percentage of average total assets was 0.15% and 0.18% for the quarters ended March 31, 2007 and 2006, respectively. The increase in G&A expenses of \$5.7 million for the quarter ended March 31, 2007 was primarily the result of increased compensation expense.

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

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
For the Quarter Ended March 31, 2007	\$12,886	0.15%
For the Year Ended December 31, 2006	\$40,063	0.17%
For the Quarter Ended December 31, 2006	\$12,219	0.16%
For the Quarter Ended September 30, 2006	\$11,542	0.18%
For the Quarter Ended June 30, 2006	\$8,985	0.18%
For the Quarter Ended March 31, 2006	\$7,177	0.18%

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

Net Income and Return on Average Equity

Our net income was \$67.4 million for the quarter ended March 31, 2007, and our net loss was \$10.9 million for the quarter ended March 31, 2006. Our return on average equity was 8.88% for the quarter ended March 31, 2007, and (2.98%) for the quarter ended March 31, 2006. We attribute the majority of the increase in net income, of \$78.3 million to the interest rate spread increase for the quarter. The increase in net interest income for the quarter ended March 31, 2007, as compared to the quarter ended March 31, 2006, was \$42.0 million. In addition to the increase in net interest income, the gain on sale of investment securities of \$6.1 million for the quarter ended March 31, 2007, as compared to the loss on sale of investment securities of \$7.0 million for the quarter ended March 31, 2006, and the decline in loss on other-than-temporarily impaired securities, from \$26.7 million for the quarter ended March 31, 2006 to \$491,000 for the quarter ended March 31, 2007, contributed to the increase in net income and the return on average equity.

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, impairment of intangibles for customer relationships, minority interest, loss on other-than-temporarily impaired securities, income from equity investment, G&A expenses, and income taxes each as a percentage of average equity, and the return on average equity for the quarter ended March 31, 2007, the year ended December 31, 2006, and the four quarters in 2006.

24

Components of Return on Average Equity (Ratios for the quarters have been annualized)

	Net Interest Income/Average Equity	Net 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	G&A Expenses/Average Equity	Income Taxes/Average Equity	Impairment of intangibles for customer relationships/Average Equity
For the Quarter Ended March 31, 2007	9.14%	0.61%	0.82%	(0.06%)	0.45%	(1.70%)	(0.34%)	
For the Year Ended December 31, 2006	8.32%	0.94%	0.34%	(2.61%)	0.20%	(2.00%)	(0.38%)	(0.38%)
For the Quarter Ended December 31, 2006	8.81%	0.67%	1.08%	(0.84%)	0.52%	(1.86%)	(0.20%)	
For the Quarter Ended September 30, 2006	7.93%	0.76%	1.44%	-	0.08%	(2.08%)	(0.41%)	

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

Quarter Ended									
June 30, 2006	9.20%	1.08%	(0.30%)	(4.91%)	-	(2.19%)	(0.33%)	(0.33%)	(0.33%)
For the									
Quarter Ended									
March 31,									
2006	7.45%	1.59%	(1.91%)	(7.28%)	-	(1.95%)	(0.57%)	(0.57%)	(0.57%)

Financial Condition

Investment Securities, Available for Sale

All of our Mortgage-Backed Securities at March 31, 2007 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. We mark-to-market all of our earning assets to fair value.

All of our agency debentures are callable and carry an implied "AAA" rating. We mark-to-market all of our agency debentures to fair value.

We accrete discount balances as an increase in interest income over the life of investment securities purchased at a discount, and we amortize premium balances as a decrease in interest income over the life of investment securities purchased at a premium. At March 31, 2007, and December 31, 2006 we had on our balance sheet a total of \$96.1 million and \$78.4 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 \$291.8 million and \$219.1 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 \$1.7 billion for the quarter ended March 31, 2007 and \$1.1 billion for the quarter ended March 31, 2006. The overall prepayment speed for the quarter ended March 31, 2007 decreased to 17%, as compared to 18% for the quarter ended March 31, 2006. 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 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.

25

The table below summarizes our Investment Securities at March 31, 2007, December 31, 2006, September 30, 2006, June 30, 2006 and March 31, 2006.

Investment Securities (dollars in thousands)						
Principal Amount	Net Premium Amortized Cost	Amortized Cost/Principal Amount	Fair Value	Fair Value	Fair Value	Fair Value

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

At March 31, 2007	\$39,053,196	\$195,649	\$39,248,845	100.50%	\$39,230,648
At December 31, 2006	\$30,134,791	\$140,709	\$30,275,500	100.47%	\$30,217,009
At September 30, 2006	\$28,297,950	\$139,717	\$28,437,667	100.49%	\$28,348,027
At June 30, 2006	\$23,822,683	\$141,671	\$23,964,354	100.59%	\$23,474,006
At March 31, 2006	\$16,288,848	\$173,428	\$16,462,276	101.06%	\$16,176,348

The tables below set forth certain characteristics of our investment securities. 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 Investment Securities
At March 31, 2007	\$9,657,221	5.79%	30 months	10.05%	5.66%	
At December 31, 2006	\$8,493,242	5.72%	19 months	9.76%	5.57%	
At September 30, 2006	\$8,291,239	5.57%	17 months	9.64%	5.47%	
At June 30, 2006	\$7,964,221	5.36%	16 months	9.75%	5.26%	
At March 31, 2006	\$7,785,082	4.99%	20 months	10.27%	5.07%	

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 March 31, 2007	\$29,395,975	5.85%	5.67%	75.27%
At December 31, 2006	\$21,641,549	5.83%	5.65%	71.82%
At September 30, 2006	\$20,006,711	5.82%	5.62%	70.70%
At June 30, 2006	\$15,858,461	5.73%	5.50%	66.57%
At March 31, 2006	\$8,503,766	5.43%	4.99%	52.21%

At March 31, 2007 and December 31, 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
March 31, 2007

One-Month Libor	Six-Month Libor	Twelve Month Libor	12-Month Moving Average	11th District Cost of Funds	1-Year Treasury Index

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

Weighted Average Term to Next Adjustment	1 mo.	17 mo.	48 mo.	1 mo.	1 mo.	24 mo.
Weighted Average Annual Period Cap	6.46%	2.20%	2.10%	0.18%	0.00%	1.90%
Weighted Average Lifetime Cap at March 31, 2007	7.27%	11.08%	10.81%	10.49%	12.07%	10.84%
Investment Principal Value as Percentage of Investment Securities at March 31, 2007	5.82%	1.97%	10.77%	0.05%	0.29%	5.48%

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

26

Adjustable-Rate Investment Securities by Index
December 31, 2006

	One-Month Libor	Six- Month Libor	Twelve Month Libor	12-Month Moving Average	11th District Cost of Funds	Six-Month CD Rate	1-Year Treasury Index
Weighted Average Term to Next Adjustment	1 mo.	35 mo.	36 mo.	1 mo.	1 mo.	3 mo.	13 mo.
Weighted Average Annual Period Cap	6.70%	1.88%	2.00%	0.16%	0.00%	1.75%	1.00%
Weighted Average Lifetime Cap at December 31, 2006	7.32%	10.39%	10.70%	10.53%	12.07%	9.75%	10.81%
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%

(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 \$7.9 million and the trading securities sold, not yet purchased, was \$39.7 million at March 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 March 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

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

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 quarter ended March 31, 2007, the term to maturity of our borrowings ranged from one day to three years. Additionally, the Company entered into structured borrowings giving the counterparty the right to call the balance prior to maturity. The weighted average original term to maturity was 245 days at March 31, 2007. For the quarter ended March 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 162 days at March 31, 2006. At March 31, 2007, the weighted average cost of funds for all of our borrowings 5.17% and the weighted average term to next rate adjustment was 200 days. At March 31, 2006, the weighted average cost of funds for all of our borrowings was 4.38% and the weighted average term to next rate adjustment was 69 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 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.

27

Borrowings under our repurchase agreements increased by \$5.8 billion to \$33.3 billion at March 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 2006 and the first quarter of 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 commitment 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 increase due to changes in market interest rates of market factors, lenders may release collateral back to us. Specifically, margin calls result from a decline in the value of the 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

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

market factors. Through March 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 March 31, 2007.

(dollars in thousands)				
	Within One Year	One to Three Years	Three to Five Years	More than Five Years
Contractual Obligations				
Repurchase agreements	\$30,848,011	-	\$1,600,000	\$900,000
Interest expense on repurchase agreements	202,460	217,947	201,335	183,944
Long-term operating lease obligations	532	931	-	-
Employment agreements	25,074	3,815	-	-
Total	\$31,076,077	\$222,693	\$1,801,335	\$1,083,944

Stockholders' Equity

During the quarter ended March 31, 2007, we declared dividends to common shareholders totaling \$52.6 million or \$0.20 per share, which were paid on April 26, 2007. During the quarter ended March 31, 2007, we declared and paid dividends to Series A Preferred shareholders totaling \$3.6 million or \$0.492188 per share, and Series B preferred shareholders totaling \$1.7 million or \$0.375 per share. During the quarter ended March 31, 2006, we declared and paid dividends to common shareholders totaling \$13.6 million or \$0.11 per share which were paid April 27, 2006. During the quarter ended March 31, 2006 we declared and paid dividends to Series A preferred shareholders totaling \$3.6 million or \$0.492188 per share.

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 before expenses of approximately \$737.4 million. This transaction settled on March 13, 2007.

28

On August 3, 2006, we entered into an ATM Equity Offering(sm) Sales Agreement with Merrill Lynch & Co. and Merrill Lynch, Pierce, Fenner & 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, will be made by means of ordinary brokers' transaction on the New York Stock Exchange. During the quarter ended March 31, 2007, no shares of our common stock were issued pursuant to this program.

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

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

of ordinary brokers' transaction on the New York Stock Exchange. During the quarter ended March 31, 2007, no shares of our common stock were issued pursuant to this program.

During the quarter ended March 31, 2007, 41,800 options were exercised under the Long-Term Stock Incentive Plan, or Incentive Plan, for an aggregate exercise price of \$417,000. During the quarter ended March 31, 2006, 16,725 options were exercised under the Incentive Plan for an aggregate exercise price of \$136,000.

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)."

The table below shows unrealized gains and losses on the Investment Securities and interest rate swaps in our portfolio.

Unrealized Gains and Losses (dollars in thousands)

	At March 31, 2007	At December 31, 2006	At September 30, 2006	At June 30, 2006	At M 31,
Unrealized gain	\$138,211	\$112,596	\$100,229	\$110,755	
Unrealized loss	(198,251)	(188,708)	(220,202)	(495,667)	
Net Unrealized (loss) gain	(\$60,040)	(\$76,112)	(\$119,973)	(\$384,912)	
Net unrealized losses as percentage of investment securities principal amount	(0.15%)	(0.25%)	(0.42%)	(1.62%)	
Net unrealized losses as percentage of investment securities amortized cost	(0.15%)	(0.25%)	(0.42%)	(1.61%)	

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. The net unrealized loss on available for sale securities and interest rate swaps was \$60.0 million, or 0.15% of the amortized cost of our investment securities as of March 31, 2007, and \$76.1 million, or 0.25% of the amortized cost of our investment securities as of December 31, 2006.

Mortgage-Backed Securities with a carrying value of \$8.3 billion were in a continuous unrealized loss position over 12 months at March 31, 2007 in the amount of \$125.8 million. Mortgage-Backed Securities with a carrying value of \$11.2 billion were in a continuous unrealized loss position for less than 12 months at March 31, 2007 in the amount of \$29.5 million. Mortgage-Backed Securities with a carrying value of \$7.0 billion were in a continuous unrealized loss position over 12 months at December 31, 2006 in the amount of \$138.2 million. Mortgage-Backed Securities with a carrying value of \$6.4 billion were in a continuous unrealized loss position for less than 12 months at December 31,

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

2006 in the amount of \$30.2 million. The decline in value of these securities is solely due to increases in interest rates. All of the Mortgage-Backed Securities are "AAA" rated or carry an implied "AAA" rating. During the quarter ended March 31, 2007 and 2006, we recorded impairment losses of \$491,000 and \$26.7 million, respectively. The remaining investments are not considered other-than-temporarily impaired since we currently have the ability and intent to hold the investments for a period of time or to maturity, if necessary, sufficient for a forecasted market price recovery up to or beyond the cost of the investments. Also, we are guaranteed payment on the par value of the securities.

29

Leverage

Our debt-to-equity ratio at March 31, 2007 and March 31, 2006 was 9.8:1 and 10.2:1 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 this range 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 March 31, 2007, we entered into swap agreements with a total notional amount of \$13.2 billion. We agreed to pay a weighted average pay rate of 5.10% and receive a floating rate based on one month LIBOR. At March 31, 2006, we entered into swap agreements with a total notional amount of \$2.8 billion. We agreed to pay a weighted average pay rate of 4.85% 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.

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

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

30

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 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 Internal Revenue Code for the quarters ended March 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, under the REIT rules for the quarters ended March 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, as of March 31, 2007 and December 31, 2006, we believe that we qualified as a REIT under the Internal Revenue 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 March 31, 2007 and December 31, 2006 we were in compliance with this requirement.

ITEM 3A QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

MARKET RISK

Market risk is the exposure to loss resulting from changes in interest rates, foreign currency exchange rates, commodity prices and equity prices. The primary market risk to which we are exposed is interest rate risk, which is highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political considerations and other factors beyond our control. Changes in the general level of interest rates can affect our net interest income, which is the difference between the interest income earned on interest-earning assets and the interest expense incurred in connection with our interest-bearing liabilities, by affecting the spread between our interest-earning assets and interest-bearing liabilities. Changes in the level of interest rates also can affect the value of our Mortgage-Backed Securities and our ability to realize gains from the sale of these assets. We may utilize a variety of financial instruments, including interest rate swaps, caps, floors, inverse floaters and other interest rate exchange contracts, in order to limit the effects of interest rates on our operations. When we use these types of derivatives to hedge the risk of interest-earning assets or interest-bearing liabilities, we may be subject to certain risks, including the risk that losses on a hedge position will reduce the funds available for payments to holders of securities and that the losses may exceed the amount we invested in the instruments.

Our profitability and the value of our portfolio (including interest rate swaps) may be adversely affected during any period as a result of changing interest rates. The following table quantifies the potential changes in net interest income, portfolio value should interest rates go up or down 25, 50, and 75 basis points, assuming the yield curves of the rate shocks will be parallel to each other and the current yield curve. All changes in income and value are measured as percentage changes from the projected net interest income and portfolio value at the base interest rate scenario. The base interest rate scenario assumes interest rates at March 31, 2007 and various estimates regarding prepayment and all activities are made at each level of rate shock. Actual results could differ significantly from these estimates.

31

Change in Interest Rate	Projected Percentage Change in Net Interest Income	Projected Percentage Change in Portfolio Value
-75 Basis Points	17.59%	1.43%
-50 Basis Points	12.74%	1.18%
-25 Basis Points	8.47%	0.80%
Base Interest Rate	-	-
+25 Basis Points	(0.28%)	(0.32%)
+50 Basis Points	(4.75%)	(1.07%)
+75 Basis Points	(9.26%)	(1.94%)

ASSET AND LIABILITY MANAGEMENT

Asset and liability management is concerned with the timing and magnitude of the repricing of assets and liabilities. We attempt to control risks associated with interest rate movements. Methods for evaluating interest rate risk include an analysis of our interest rate sensitivity "gap", which is the difference between interest-earning assets and interest-bearing liabilities maturing or repricing within a given time period. A gap is considered positive when the amount of interest-rate sensitive assets exceeds the amount of interest-rate sensitive liabilities. A gap is considered negative when the

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

amount of interest-rate sensitive liabilities exceeds interest-rate sensitive assets. During a period of rising interest rates, a negative gap would tend to adversely affect net interest income, while a positive gap would tend to result in an increase in net interest income. During a period of falling interest rates, a negative gap would tend to result in an increase in net interest income, while a positive gap would tend to affect net interest income adversely. Because different types of assets and liabilities with the same or similar maturities may react differently to changes in overall market rates or conditions, changes in interest rates may affect net interest income positively or negatively even if an institution were perfectly matched in each maturity category.

The following table sets forth the estimated maturity or repricing of our interest-earning assets and interest-bearing liabilities at March 31, 2007. The amounts of assets and liabilities shown within a particular period were determined in accordance with the contractual terms of the assets and liabilities, except adjustable-rate loans, and securities are included in the period in which their interest rates are first scheduled to adjust and not in the period in which they mature and does include the effect of the interest rate swaps. The interest rate sensitivity of our assets and liabilities in the table could vary substantially if based on actual prepayment experience.

	Within 3 Months	4-12 Months	More than 1 Year to 3 Years	3 Years and Over
	(dollars in thousands)			

Rate Sensitive Assets:				
Investment Securities (Principal)	\$2,857,810	\$1,457,782	\$8,628,830	\$26,108,7
Rate Sensitive Liabilities:				
Repurchase Agreements, with the effect of swaps	\$17,550,011	\$2,044,650	\$5,328,700	\$8,424,6

Interest rate sensitivity gap	(\$14,692,201)	(\$586,868)	\$3,300,130	\$17,684,1
=====				
Cumulative rate sensitivity gap	(\$14,692,201)	(\$15,279,069)	(\$11,978,939)	\$5,705,1
=====				
Cumulative interest rate sensitivity gap as a percentage of total rate- sensitive assets	(38%)	(39%)	(31%)	
=====				

Our analysis of risks is based on management's experience, estimates, models and assumptions. These analyses rely on models which utilize estimates of fair value and interest rate sensitivity. Actual economic conditions or implementation of investment decisions by our management may produce results that differ significantly from the estimates and assumptions used in our models and the projected results shown in the above tables and in this report. These analyses contain certain forward-looking statements and are subject to the safe

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

harbor statement set forth under the heading, "Special Note Regarding Forward-Looking Statements."

ITEM 4. CONTROLS AND PROCEDURES

Our management, including our Chief Executive Officer (the "CEO") and Chief Financial Officer (the "CFO"), reviewed and evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) of the Securities Exchange Act) as of the end of the period covered by this quarterly report. Based on that review and evaluation, the CEO and CFO have concluded that our current disclosure controls and procedures, as designed and implemented, (1) were effective in ensuring that information regarding the Company and its subsidiaries is made known to our management, including our CEO and CFO, by our employees, as appropriate to allow timely decisions regarding required disclosure and (2) were effective in providing reasonable assurance that information the Company must disclose in its periodic reports under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods prescribed by the SEC's rules and forms. There have been no changes in our internal control over financial reporting that occurred during the last fiscal quarter that have materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

33

PART II. OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

From time to time, we are 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 adverse effect on our consolidated financial statements.

Item 1A. RISK FACTORS

There have been no material changes to the risk factors disclosed in Item 1A -- Risk Factors of our annual report on Form 10-K for the year ended December 31, 2006 (the "Form 10-K"). The materialization of any risks and uncertainties identified in our forward looking statements contained in this report together with those previously disclosed in the Form 10-K or those that are presently unforeseen could result in significant adverse effects on our financial condition, results of operations and cash flows. See Item 2. "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Special Note Regarding Forward Looking Statements" in this quarterly report on Form 10-Q.

ITEM 6 EXHIBITS

Exhibits:

The exhibits required by this item are set forth on the Exhibit Index attached hereto.

EXHIBIT INDEX

Exhibit Number	Exhibit Description
-----	-----
3.1	Articles of Amendment and Restatement of the Articles of Incorporation

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

of the Registrant (incorporated by reference to Exhibit 3.2 to the Registrant's Registration Statement on Form S-11 (Registration No. 333-32913) filed with the Securities and Exchange Commission on August 5, 1997).

- 3.2 Articles of Amendment of the Articles of Incorporation of the Registrant (incorporated by reference to Exhibit 3.1 of the Registrant's Registration Statement on Form S-3 (Registration Statement 333-74618) filed with the Securities and Exchange Commission on June 12, 2002).
 - 3.3 Articles of Amendment of the Articles of Incorporation of the Registrant (incorporated by reference to Exhibit 3.1 of the Registrant's Form 8-K (filed with the Securities and Exchange Commission on August 3, 2006).
 - 3.4 Form of Articles Supplementary designating the Registrant's 7.875% Series A Cumulative Redeemable Preferred Stock, liquidation preference \$25.00 per share (incorporated by reference to Exhibit 3.3 to the Registrant's 8-A filed April 1, 2004).
 - 3.5 Articles Supplementary of the Registrant's designating an additional 2,750,000 shares of the Company's 7.875% Series A Cumulative Redeemable Preferred Stock, as filed with the State Department of Assessments and Taxation of Maryland on October 15, 2004 (incorporated by reference to Exhibit 3.2 to the Registrant's 8-K filed October 4, 2004).
 - 3.6 Articles Supplementary designating the Registrant's 6% Series B Cumulative Convertible Preferred Stock, liquidation preference \$25.00 per share (incorporated by reference to Exhibit 3.1 to the Registrant's 8-K filed April 10, 2006).
 - 3.7 Bylaws of the Registrant, as amended (incorporated by reference to Exhibit 3.3 to the Registrant's Registration Statement on Form S-11 (Registration No. 333-32913) filed with the Securities and Exchange Commission on August 5, 1997).
 - 4.1 Specimen Common Stock Certificate (incorporated by reference to Exhibit 4.1 to Amendment No. 1 to the Registrant's Registration Statement on Form S-11 (Registration No. 333-32913) filed with the Securities and Exchange Commission on September 17, 1997).
- 34
- 4.2 Specimen Preferred Stock Certificate (incorporated by reference to Exhibit 4.2 to the Registrant's Registration Statement on Form S-3 (Registration No. 333-74618) filed with the Securities and Exchange Commission on December 5, 2001).
 - 4.3 Specimen Series A Preferred Stock Certificate (incorporated by reference to Exhibit 4.1 of the Registrant's Registration Statement on Form 8-A filed with the SEC on April 1, 2004).
 - 4.4 Specimen Series B Preferred Stock Certificate (incorporated by reference to Exhibit 4.1 to the Registrant's Form 8-K filed with the Securities and Exchange Commission on April 10, 2006).
 - 31.1 Certification of Michael A.J. Farrell, Chairman, Chief Executive Officer, and President of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

- 31.2 Certification of Kathryn F. Fagan, Chief Financial Officer and Treasurer of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Michael A.J. Farrell, Chairman, Chief Executive Officer, and President of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Kathryn F. Fagan, Chief Financial Officer and Treasurer of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

35

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ANNALY CAPITAL MANAGEMENT, INC.

Dated: May 10, 2007

By: /s/ Michael A.J. Farrell

Michael A.J. Farrell
(Chairman of the Board, Chief Executive Officer, President and authorized officer of registrant)

Dated: May 10, 2007

By: /s/ Kathryn F. Fagan

Kathryn F. Fagan
(Chief Financial Officer and Treasurer and principal financial and chief accounting officer)

36