# FORM 10−Q

## ANNALY MORTGAGE MANAGEMENT INC − NLY

**Filed: August 13, 2003 (period: June 30, 2003)**

Quarterly report which provides a continuing view of a company's financial position

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## PART 1.



## PART II.

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED: JUNE 30, 2003

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

| | |
|---|---|
| MARYLAND | 22-3479661 |
| (State or other jurisdiction of incorporation or organization) | (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 an accelerated filer ( as defined in Rule 12b-2 of the Exchange Act):

Yes X No

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

| Class | Outstanding at August 13, 2003 |
|---|---|
| Common Stock, $.01 par value | 94,061,723 |

Annaly Mortgage Management, Inc.

FORM 10-Q

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PART 1.

ITEM 1. FINANCIAL STATEMENTS

ANNALY MORTGAGE MANAGEMENT, INC.
STATEMENTS OF FINANCIAL CONDITION
(dollars in thousands, except per share amounts)

| | JUNE 30, 2003 (UNAUDITED) | DECEMBER 31, 2002 |
|---|---|---|
| ASSETS | | |
| Cash and cash equivalents | $ 304 | $ 726 |
| Mortgage-Backed Securities, at fair value | 12,887,495 | 11,551,857 |
| Agency Debentures, at fair value | 1,375,980 | - |
| Receivable for Mortgage-Backed Securities sold | 387,218 | 55,954 |
| Accrued interest receivable | 58,026 | 49,707 |
| Other assets | 1,104 | 840 |
| Total assets | $14,710,127 | $11,659,084 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Liabilities: | | |
| Repurchase agreements | $ 12,162,333 | $10,163,174 |
| Payable for investment securities purchased | 1,306,238 | 338,691 |
| Accrued interest payable | 16,788 | 14,935 |
| Dividends payable | 56,420 | 57,499 |
| Other liabilities | 4,708 | 2,812 |
| Accounts payable | 2,202 | 1,907 |
| Total liabilities | 13,548,689 | 10,579,018 |
| Commitments | | |
| Stockholders' Equity: | | |
| Common stock: par value $.01 per share; 500,000,000 Authorized, 94,030,753 and 84,569,206 shares issued and outstanding, respectively | 940 | 846 |
| Additional paid-in capital | 1,157,092 | 1,003,200 |
| Accumulated other comprehensive income | 1,190 | 75,511 |
| Retained earnings | 2,216 | 509 |
| Total stockholders' equity | 1,161,438 | 1,080,066 |
| Total liabilities and stockholders' equity | $14,710,127 | $11,659,084 |

See notes to financial statements.

PART 1.
ITEM 1. FINANCIAL STATEMENTS

ANNALY MORTGAGE MANAGEMENT, INC.
STATEMENTS OF OPERATIONS
(UNAUDITED)
(dollars in thousands, except per share amounts)

| | For the Quarter Ended June 30, 2003 | For the Quarter Ended June 30, 2002 | For the Six Months Ended June 30, 2003 | For the Six Months Ended June 30, 2002 |
|---|---|---|---|---|
| INTEREST INCOME | $93,892 | $109,423 | $181,392 | $202,322 |
| INTEREST EXPENSE | 51,770 | 47,860 | 95,818 | 87,872 |
| NET INTEREST INCOME | 42,122 | 61,563 | 85,574 | 114,450 |
| GAIN ON SALE OF MORTGAGE-BACKED SECURITIES | 20,231 | 1,342 | 31,252 | 4,753 |
| GENERAL AND ADMINISTRATIVE EXPENSES | 4,201 | 3,536 | 7,898 | 6,791 |
| NET INCOME | 58,152 | 59,369 | 108,928 | 112,412 |
| OTHER COMPREHENSIVE INCOME (LOSS): | | | | |
| Unrealized gain (loss) on available-for-sale securities | (49,579) | 38,123 | (43,069) | 33,866 |
| Less: reclassification adjustment for net gains included in net income | (20,231) | (1,342) | (31,252) | (4,753) |
| Other comprehensive income (loss) | (69,810) | 36,781 | (74,321) | 29,113 |
| COMPREHENSIVE INCOME (LOSS) | $(11,658) | $96,150 | $34,607 | $141,526 |
| NET INCOME PER SHARE: | | | | |
| Basic | $0.62 | $0.72 | $1.22 | $1.41 |
| Diluted | $0.62 | $0.71 | $1.22 | $1.40 |
| WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING: | | | | |
| Basic | 93,384,128 | 82,910,206 | 89,019,821 | 79,954,529 |
| Diluted | 93,588,024 | 83,186,865 | 89,231,272 | 80,245,372 |

See notes to financial statements.

PART I
ITEM 1. FINANCIAL STATEMENTS

ANNALY MORTGAGE MANAGEMENT, INC.
STATEMENT OF STOCKHOLDERS' EQUITY
FOR THE SIX MONTHS ENDED JUNE 30, 2003
(UNAUDITED)
(dollars in thousands, except per share amounts)

| | Common Stock Par Value | Additional Paid-In Capital | Comprehensive Income | Retained Earnings | Accumulated Other Comprehensive Income | Total |
|---|---|---|---|---|---|---|
| BALANCE, DECEMBER 31, 2002 | $846 | $1,003,200 | | $509 | $75,511 | $1,080,066 |
| Net income | | | $50,775 | 50,775 | | |
| Other comprehensive income: | | | | | | |
| Unrealized net gain on securities, net of reclassification adjustment | | | (4,511) | | (4,511) | |
| Comprehensive income | | | $46,264 | | | 46,264 |
| Exercise of stock options | - | 215 | | | | 215 |
| Proceeds from direct purchase and dividend reinvestment | - | 955 | | | | 955 |
| Dividends declared for the quarter ended March 31, 2003, $0.60 per share | | | | (50,788) | | (50,788) |
| BALANCE, MARCH 31, 2003 | $846 | $1,004,370 | | $496 | $71,000 | $1,076,712 |
| Net income | | | $58,152 | 58,152 | | |
| Other comprehensive income: | | | | | | |
| Unrealized net loss on securities, net of reclassification adjustment | | | (69,810) | | (69,810) | |
| Comprehensive income | | | $(11,658) | | | (11,658) |
| Exercise of stock options | - | 154 | | | | 154 |
| Proceeds from direct purchase and dividend reinvestment | 1 | 1,346 | | | | 1,347 |
| Proceeds from secondary offering | 93 | 151,222 | | | | 151,315 |
| Dividends declared for the quarter ended June 30, 2003, $0.60 per share | | | | (56,432) | | (56,432) |
| BALANCE, JUNE 30, 2003 | $940 | $1,157,092 | | $2,216 | $1,190 | $1,161,438 |

See notes to financial statements.

PART I
ITEM 1. FINANCIAL STATEMENTS

ANNALY MORTGAGE MANAGEMENT, INC.
STATEMENTS OF CASH FLOWS
(UNAUDITED)
(dollars in thousands)

| | For the Quarter Ended June 30, 2003 | For the Quarter Ended June 30, 2002 | For the Six Months Ended June 30, 2003 | For the Six Months Ended June 30, 2002 |
|---|---|---|---|---|
| Cash flows from operating activities: | | | | |
| Net income | $ 58,152 | $ 59,369 | $ 108,928 | $ 112,412 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | | |
| Amortization of mortgage premiums and discounts, net | 57,614 | 19,797 | 106,133 | 37,688 |
| Gain on sale of Mortgage-Backed Securities | (20,231) | (1,343) | (31,252) | (4,753) |
| Stock option expense | 58 | 101 | 60 | 163 |
| Market value adjustment on long-term repurchase agreement | 1,993 | (406) | 2,097 | (369) |
| (Increase) decrease in accrued interest receivable | (7,939) | 449 | (8,319) | (4,049) |
| (Increase) in other assets | (232) | (850) | (265) | (1,046) |
| Increase (decrease) in accrued interest payable | 873 | (746) | 1,853 | 4,667 |
| Increase in accounts payable | 1,169 | 763 | 295 | 851 |
| Net cash provided by operating activities | 91,457 | 77,134 | 179,530 | 145,564 |
| Cash flows from investing activities: | | | | |
| Purchase of Mortgage-Backed Securities | (4,920,184) | (2,151,127) | (7,217,253) | (5,989,743) |
| Purchase of agency debentures | (1,170,000) | - | (1,341,000) | - |
| Proceeds from sale of Mortgage-Backed Securities | 1,576,147 | 414,974 | 2,112,393 | 808,436 |
| Proceeds from callable agency debentures | 171,000 | - | 171,000 | - |
| Principal payments of Mortgage-Backed Securities | 2,178,798 | 864,902 | 4,050,322 | 1,957,893 |
| Net cash used in investing activities | (2,164,239) | (871,251) | (2,224,538) | (3,223,414) |
| Cash flows from financing activities: | | | | |
| Proceeds from repurchase agreements | 31,387,072 | 22,122,302 | 55,682,830 | 41,949,911 |
| Principal payments on repurchase agreements | (29,416,888) | (21,276,899) | (53,683,870) | (39,132,937) |
| Proceeds from exercise of stock options | 94 | 265 | 309 | 485 |
| Proceeds from direct purchase and dividend reinvestment | 1,349 | 831 | 2,302 | 1,390 |
| Net proceeds from secondary offerings | 151,315 | - | 151,315 | 347,337 |
| Dividends paid | (50,801) | (52,223) | (108,300) | (88,119) |
| Net cash provided by financing activities | 2,072,141 | 794,276 | 2,044,586 | 3,078,067 |
| Net increase (decrease) in cash and cash equivalents | (641) | 159 | (422) | 217 |
| Cash and cash equivalents, beginning of period | 945 | 487 | 726 | 429 |
| Cash and cash equivalents, end of period | $ 304 | $ 646 | $ 304 | $ 646 |
| Supplemental disclosure of cash flow information: | | | | |
| Interest paid | $ 50,897 | $ 48,607 | $ 93,965 | $ 83,205 |
| Noncash financing activities: | | | | |
| Net change in unrealized gain (loss) on available-for-sale securities net of reclassification adjustment | $ (69,810) | $ 36,781 | $ (74,321) | $ 29,113 |
| Dividends declared, not yet paid | $ 56,420 | $ 56,404 | $ 56,420 | $ 56,404 |

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1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Annaly Mortgage Management, Inc. (the "Company") was incorporated in Maryland on November 25, 1996. 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.

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

Basis of Presentation - The accompanying unaudited 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 interim financial statements for the three month period 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 results of operations have been included. These unaudited financial statements should be read in conjunction with the audited financial statements included in the Company's Annual Report on form 10-K for the year ended December 31, 2002. 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.

Cash and Cash Equivalents - Cash and cash equivalents includes cash on hand and money market funds. The carrying amounts of cash equivalents approximates their value.

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 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."

Statement of Financial Accounting Standards No. 115, Accounting for Certain Investments in Debt and Equity Securities, requires the Company to classify its investments 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 statement of financial condition. Accordingly, this flexibility requires the Company to classify all of its Investment Securities as available-for-sale. All assets classified as available-for-sale are reported at fair value, based on market prices provided by certain dealers who make markets in these financial instruments, with unrealized gains and losses excluded from earnings and reported as a separate component of stockholders' equity.

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 Mortgage-Backed Securities is adjusted. There were no such adjustments for the quarters ended June 30, 2003 and 2002.

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 Mortgage-Backed Securities are amortized into interest income over the lives of the securities using the interest method.

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 such transactions are determined on the specific identification basis.

Credit Risk − At June 30, 2003 and December 31, 2002, the Company has limited its exposure to credit losses on its portfolio of Investment Securities by only purchasing securities issued by Federal Home Loan Mortgage Corporation ("FHLMC"), Federal National Mortgage Association ("FNMA"), Government National Mortgage Association ("GNMA"), or Federal Home Loan Bank ("FHLB"). The payment of principal and interest on the FHLMC, FNMA, and FHLB Investment 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. At June 30, 2003 and December 31, 2002 all of the Company's Investment Securities have an actual or implied "AAA" rating.

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. Accrued interest is recorded as a separate line item.

Income Taxes − The Company has elected to be taxed as a Real Estate Investment Trust ("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.

Use of Estimates − The preparation of 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.

New Accounting Pronouncement − In December 2002, the FASB issued Statement of Financial Accounting Standard (SFAS) No. 148, "Accounting for Stock−Based Compensation−Transition and Disclosures, an Amendment of FASB Statement No. 123" (SFAS No. 148). This Statement provides alternative methods of transition for companies who voluntarily change to the fair value−based method of accounting for stock−based employee compensation in accordance with SFAS No. 123, "Accounting for Stock−Based Compensation" (SFAS No. 123). SFAS No. 148 does not permit the use of the original SFAS No. 123 prospective method of transition for changes to the fair value based method made in fiscal years beginning after December 15, 2003. The Statement also requires prominent disclosures in both annual and interim financial statements about the method of accounting for stock−based compensation and the effect of the method used on reported results. This Statement is effective upon issuance.

## 2. MORTGAGE−BACKED SECURITIES

The following table pertains to the Company's Mortgage−Backed Securities classified as available−for−sale as of June 30, 2003, which are carried at their fair value:

| | Federal Home Loan Mortgage Corporation | Federal National Mortgage Association | Government National Mortgage Association | Total Mortgage−Backed Securities |
|---|---|---|---|---|
| | (dollars in thousands) | | | |
| Mortgage−Backed | | | | |
| Securities, gross | $4,737,720 | $7,464,489 | $362,238 | $12,564,447 |
| Unamortized discount | (21) | (1,046) | (14) | (1,081) |
| Unamortized premium | 102,262 | 214,700 | 6,957 | 323,919 |
| Amortized cost | 4,839,961 | 7,678,143 | 369,181 | 12,887,285 |
| Gross unrealized gains | 17,863 | 30,105 | 1,687 | 49,655 |
| Gross unrealized losses | (25,017) | (23,938) | (490) | (49,445) |
| Estimated fair value | $4,832,807 | $7,684,310 | $370,378 | 12,887,495 |

| | Amortized Cost | Gross Unrealized Gain | Gross Unrealized Loss | Estimated Fair Value |
|---|---|---|---|---|
| Adjustable rate | 7,848,276 | 31,674 | (28,510) | 7,851,440 |
| Fixed rate | 5,039,009 | 17,981 | (20,935) | 5,036,055 |
| Total | 12,887,285 | 49,655 | (49,445) | 12,887,495 |

The following table pertains to the Company's Mortgage−Backed Securities classified as available−for−sale as of December 31, 2002, which are carried at their fair value:

| | Federal Home | Federal National | Government | Total |
|---|---|---|---|---|

| | Loan Mortgage Corporation | Mortgage Association | National Mortgage Association | Mortgage-Backed Securities |
|---|---|---|---|---|
| | (dollars in thousands) | | | |
| Mortgage-Backed | | | | |
| Securities, gross | $ 5,120,929 | $5,860,987 | $ 220,468 | $11,202,384 |
| Unamortized discount | (544) | (120) | - | (664) |
| Unamortized premium | 105,872 | 164,071 | 4,684 | 274,627 |
| Amortized cost | 5,226,257 | 6,024,938 | 225,152 | 11,476,347 |
| Gross unrealized gains | 31,731 | 58,239 | 537 | 90,507 |
| Gross unrealized losses | (9,554) | (5,318) | (125) | (14,997) |
| Estimated fair value | $ 5,248,434 | $ 6,077,859 | $ 225,564 | $11,551,857 |

| | Amortized Cost | Gross Unrealized Gain | Gross Unrealized Loss | Estimated Fair Value |
|---|---|---|---|---|
| Adjustable rate | $ 7,144,741 | $ 35,349 | $ (12,424) | $7,167,666 |
| Fixed rate | 4,331,606 | 55,158 | (2,573) | 4,384,191 |
| Total | $11,476,347 | $ 90,507 | $ (14,997) | $11,551,857 |

The adjustable rate Mortgage-Backed Securities are limited by periodic caps (generally interest rate adjustments are limited to no more than 1% every six months) and lifetime caps. The weighted average lifetime cap was 10.1% at June 30, 2003 and 8.8% at December 31, 2002.

During the six months ended June 30, 2003, the Company realized $31.3 million in gains from sales of Mortgage-Backed Securities. During the six months ended June 30, 2002, the Company realized $4.8 million in gains from sales of Mortgage-Backed Securities.

3. AGENCY DEBENTURES

At June 30, 2003, the Company owned callable agency debentures totaling $1.4 billion. FHLMC, FNMA, and FHLB are the issuers of the debentures. All of the Company's agency debentures are classified as available-for-sale. The unrealized gain on the Company's agency debentures at June 30, 2003 was $980,000. The Company's agency debentures are adjustable rate and fixed rate with a weighted average lifetime cap of 6.56%.

4. REPURCHASE AGREEMENTS

The Company had outstanding $12,162,333,000 and $10,163,174,000 of repurchase agreements with a weighted average borrowing rate of 1.50% and 1.72% and a weighted average remaining maturity of 93 days and 124 days as of June 30, 2003 and December 31, 2002, respectively.

At June 30, 2003 and December 31, 2002, the repurchase agreements had the following remaining maturities:

| | June 30, 2003 | December 31, 2002 |
|---|---|---|
| | (dollars in thousands) | |
| Within 30 days | $6,663,647 | $ 7,778,003 |
| 30 to 59 days | 3,923,662 | 816,906 |
| 60 to 89 days | - | 104,500 |
| 90 to 119 days | 111,060 | - |
| Over 120 days | 1,463,964 | 1,463,765 |
| Total | $12,162,333 | $10,163,174 |

5. OTHER LIABILITIES

In July 2001, the Company entered into a repurchase agreement maturing in July 2004 which grants the buyer the right to extend the agreement, in whole or in part, in three-month increments up to July 2006. The repurchase agreement has a principal value of $100,000,000. The Company accounts for the extension option as a separate interest rate floor liability carried at fair value. The initial fair value of $1,205,000 allocated to the interest rate floor resulted in a similar discount on the repurchase agreement borrowings that is being amortized over the initial term of 3 years using the effective yield method. At June 30, 2003, the fair value of this interest rate floor was a $4,708,000 and was classified as other liabilities.

6. COMMON STOCK

During the six months ended June 30, 2003, the Company declared dividends to shareholders totaling $107,220,000 or $1.20 per share, which $56,420,000 was paid on July 31, 2003.

On April 1, 2003, the Company entered into an underwriting agreement pursuant to which the Company raised approximately net proceeds of approximately $151.3 million in equity in a secondary offering of 9,300,700 shares of common stock.

During the six months ended June 30, 2003, 35,622 options were exercised under the long-term compensation plan at $369,000. Also, 125,225 shares were purchased in the dividend reinvestment and direct purchase program at $2,302,000.

During the Company's year ended December 31, 2002, the Company declared dividends to shareholders totaling $223,602,000, or $2.67 per share, of which $166,102,000 was paid during the year and $57,499,000 was paid on January 29, 2003.

During the year ended December 31, 2002, the Company completed an offering of common stock in the first quarter issuing 23,000,000 shares, with aggregate net proceeds of approximately $347,337,000. Through the Equity Shelf Program, the Company raised $28,103,000 in net proceeds and issued 1,484,100 shares.

During the year ended December 31, 2002, 97,095 options were exercised at $1,090,000. Total shares exchanged upon exercise of the stock options were 4,444 at a value of $76,000. Also, 165,480 shares were purchased in dividend reinvestment and share purchase plan, totaling $3,009,000.

7. EARNINGS PER SHARE (EPS)

For the quarter ended June 30, 2003, the reconciliation is as follows:

| | For the Quarter Ended June 30, 2003 (dollars in thousands, except per share amounts) | | |
|---|---|---|---|
| | Income (Numerator) | Weighted Average Shares (Denominator) | Per-Share Amount |
| Net income | $58,152 | | |
| Basic earnings per share | $58,152 | 93,384,128 | $0.62 |
| Effect of dilutive securities: | | | |
| Dilutive stock options | | 203,896 | |
| Diluted earnings per share | $58,152 | 93,588,024 | $0.62 |

Options to purchase 12,500 shares of stock were outstanding and considered anti-dilutive as their exercise price exceeded the average stock price for the quarter.

For the quarter ended June 30, 2002, the reconciliation is as follows:

| | For the Quarter Ended June 30, 2002 (dollars in thousands, except per share amounts) | | |
|---|---|---|---|
| | Income (Numerator) | Weighted Average Shares (Denominator) | Per-Share Amount |
| Net income | $59,369 | | |
| Basic earnings per share | $59,369 | 82,910,206 | $0.72 |
| Effect of dilutive securities: | | | |
| Dilutive stock options | | 276,659 | |
| Diluted earnings per share | $59,369 | 83,186,865 | $0.71 |

Options to purchase 6,250 shares of stock were outstanding and considered anti-dilutive as their exercise price exceeded the average stock price for the quarter.

For the six months ended June 30, 2003, the reconciliation is as follows:

| | For the Six Months Ended June 30, 2003 (dollars in thousands, except per share amounts) | | |
|---|---|---|---|
| | Income (Numerator) | Weighted Average Shares (Denominator) | Per-Share Amount |
| Net income | $108,928 | | |
| Basic earnings per share | 108,928 | 89,019,821 | $1.22 |
| Effect of dilutive securities: | | | |
| Dilutive stock options | | 211,451 | |
| Diluted earnings per share | $108,928 | 89,231,272 | $1.22 |

Options to purchase 12,500 shares of stock were outstanding and considered anti-dilutive as their exercise price exceeded the average stock price for the six months ended June 30, 2003.

For the six months ended June 30, 2002, the reconciliation is as follows:

| | For the Six Months Ended June 30, 2002 (dollars in thousands, except per share amounts) | | |
|---|---|---|---|
| | Income (Numerator) | Weighted Average Shares (Denominator) | Per-Share Amount |
| Net income | $112,412 | | |
| Basic earnings per share | 112,412 | 79,954,529 | $1.41 |
| Effect of dilutive securities: | | | |
| Dilutive stock options | | 290,843 | |
| Diluted earnings per share | $112,412 | 80,245,372 | $1.40 |

Options to purchase 6,250 shares of stock were outstanding and considered anti-dilutive as their exercise price exceeded the average stock price for the six months ended June 30, 2003.

## 8. LONG-TERM STOCK INCENTIVE PLAN

The Company has adopted a long term stock incentive plan for executive officers, key employees and nonemployee directors (the "Incentive Plan"). The Incentive Plan authorizes the Compensation Committee of the board of directors to grant awards, including incentive stock options as defined under Section 422 of the Code ("ISOs") and options not so qualified ("NQSOs"). 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 fully diluted outstanding shares of the Company's common stock.

The Company has elected to follow Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25") and related interpretations in accounting for its employee stock options because the alternative fair value accounting provided for under SFAS No. 123, as amended by SFAS No. 148, requires use of option valuation models that were not developed for use in valuing employee stock options. Under APB 25, because the exercise price of the Company's employee stock options equals the market price of the underlying stock on the date of grant, no compensation expense is recognized.

There were 6,250 stock options granted during the quarters ended June 30, 2003 and 2002. The fair value at date of grant for stock options granted during six months ended June 30, 2003 and 2002 was $0.69 and $0.83 per option, respectively. The fair value of stock options at date of grant was estimated using the Black-Scholes option pricing model utilizing the following weighted average assumptions:

| | For the Year Ended December 31, 2002 | 2001 |
|---|---|---|
| Risk-free interest rate | 2.49% | 4.02% |
| Expected option life in years | 5 | 5 |
| Expected stock price volatility | 22% | 26% |
| Expected dividend yield | 11.28% | 13.57% |

Because the Company's employee stock options have characteristics significantly different from those of traded options and changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not provide a reliable single measure of the fair value of its employee stock options. The Black-Scholes option pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are freely transferable. All available option pricing models require the input of highly subjective assumptions including the expected stock price volatility.

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123, Accounting for Stock-Based Compensation, to stock-based employee compensation.

| | For the Quarter Ended June 30, 2003 | 2002 | For the Six months Ended June 30, 2003 | 2002 |
|---|---|---|---|---|
| Net income, as reported | $58,152 | $59,369 | $108,928 | $112,412 |
| Deduct: Total stock-based employee compensation expense determined under fair value based method | (4) | (5) | (9) | (10) |
| Pro-forma net income | $58,148 | $59,364 | $108,919 | $112,402 |
| Net income per share, as reported | | | | |
| Basic | $0.62 | $0.72 | $1.22 | $1.41 |
| Diluted | $0.62 | $0.71 | $1.22 | $1.40 |
| Pro-forma net income per share | | | | |
| Basic | $0.62 | $0.72 | $1.22 | $1.41 |
| Diluted | $0.62 | $0.71 | $1.22 | $1.40 |

## 9. COMPREHENSIVE INCOME

The Company adopted Statement of Financial Accounting Standards No. 130, Reporting Comprehensive Income, (SFAS No. 130). SFAS No. 130 requires the reporting of comprehensive income in addition to net income from operations. Comprehensive income is a more inclusive financial reporting methodology that includes disclosure of certain financial information that historically has not been recognized in the calculation of net income. The Company at June 30, 2003 and December 31, 2002 held securities classified as available-for-sale. At June 30, 2003, the net unrealized gain totaled $1.2 million and at December 31, 2002, the net unrealized gain totaled $75.5 million.

## 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:

| | (dollars in thousands) |
|---|---|
| 2003 | 500 |
| 2004 | 500 |
| 2005 | 500 |
| 2006 | 530 |
| 2007 | 532 |
| Thereafter | 1,064 |
| Total remaining lease payments | $3,626 |

11. RELATED PARTY TRANSACTION

Mr. Farrell, on behalf of FIDAC, has approached us about the possibility of us acquiring FIDAC. Our board of directors has formed a special committee of independent directors to consider this matter and the special committee has retained independent counsel and an independent financial adviser to assist it. If our board of directors, based upon a favorable recommendation of the special committee, with Mr. Farrell and Ms. Denahan abstaining, determines that we should acquire FIDAC, we expect that such proposed acquisition will be submitted to a vote of our stockholders. We have not decided whether we will pursue this opportunity and either party may at any time determine not to proceed with this proposed acquisition without any further obligation.

Michael A.J. Farrell, our Chairman of the Board, Chief Executive Officer and President, Wellington J. Denahan, our Vice Chairman and Chief Investment Officer, Kathryn F. Fagan, our Chief Financial Officer and Treasurer, Jennifer A. Stephens, our Executive Vice President and Secretary, and other of our officers and employees are the shareholders of Fixed Income Discount Advisory Company (or FIDAC). Mr. Farrell, Ms. Denahan and other officers and employees are actively involved in managing mortgage-backed securities and other fixed income assets on behalf of FIDAC.

Mr. Farrell, on behalf of FIDAC, has approached us about the possibility of us acquiring FIDAC. Our board of directors formed a special committee of independent directors to consider this matter and the special committee retained independent counsel and an independent financial adviser to assist it. The special committee has determined that we should make an offer to acquire FIDAC. We expect that based upon that determination, our board of directors, with Mr. Farrell and Ms. Denahan abstaining, will approve our making of an offer to acquire FIDAC.

The price and terms of our offer to acquire FIDAC have not yet been determined. We believe, however, that the purchase price will be payable in shares of our common stock.

No assurances can be made as to when or whether we will acquire FIDAC. We cannot predict the terms and conditions of the proposed acquisition. We cannot be sure whether FIDAC will agree to the terms and conditions of our offer. Either party may at any time determine not to proceed with this proposed acquisition without any further obligation. In addition, we cannot be sure of the potential consequences of us acquiring or not acquiring FIDAC.

If we are able to reach an agreement to acquire FIDAC, we expect that the proposed acquisition will be submitted to a vote of our stockholders.

Our management currently allocates rent and other general and administrative expenses in the amounts of 90% and 10% to the Company and FIDAC, respectively.

12. 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 Mortgage-Backed Securities and the Company's ability to realize gains from the sale of these assets.

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. In addition, although the Company has not done so to date, the Company may seek to mitigate the potential impact on net income of periodic and lifetime coupon adjustment restrictions in the portfolio of Mortgage-Backed Securities by entering into interest rate agreements such as interest rate caps and interest rate swaps.

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.

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 the Private Securities Litigation Reform Act of 1995. Forward-looking statements which are based on various assumptions, (some of which are beyond our control) may be identified by reference to a future period or periods, or by the use of forward-looking terminology, such as "may," "will," "believe," "expect," "anticipate," "continue," or similar terms or variations on those terms, or the negative of those terms. Actual results could differ materially from those set forth in forward-looking statements due to a variety of factors, including, but not limited to, changes in interest rates, changes in yield curve, changes in prepayment rates, the availability of mortgage backed securities for purchase, the availability of financing and, if available, the terms of any financing. 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 2002 Form 10-K. 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

Annaly Mortgage Management, Inc. ("we" or "us") are a real estate investment trust that owns and manages a portfolio of Investment Securities which consist of Mortgage-Backed Securities and agency debentures. 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.

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 GAAP. 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 our financial statements. The following is a summary our policies that is most affected by management's judgments, estimates and assumptions.

Market Valuation of Securities: All assets classified as available-for-sale are reported at fair value, based on market prices. Our policy is to obtain market values from three independent sources and record the market value of the securities based on the average of the three.

Amortization of premiums and accretion of discounts: Premiums and discounts associated with the purchase of the Investment Securities are amortized into interest income over the lives of the securities using the interest method. Our policy for estimating prepayment speeds for calculating the effective yield is to evaluate historical performance, street consensus prepayment speeds, and current market conditions.

Results of Operations: For the Quarters and Six Months Ended June 30, 2003 and 2002

Net Income Summary

For the quarter ended June 30, 2003, our net income was $58.2 million, or $0.62 basic earnings per average share, as compared to $59.4 million, or $0.72 basic earnings per average share, for the quarter ended June 30, 2002. We attribute the decrease in net income for the quarter ended June 30, 2003, over the quarter ended June 30, 2002, to the decline in the interest rate spread between the rate on interest-earning assets and the cost of funds for interest-bearing liabilities. We compute our net income per share by dividing net income by the weighted average number of shares of outstanding common stock during the period, which was 93,384,128 for the quarter ended June 30, 2003 and 82,910,206 for the quarter ended June 30, 2002. Dividends per shares outstanding for the quarter ended June 30, 2003 was $0.60 per share, or $56.4 million in total. Dividends per shares outstanding for the quarter ended June 30, 2002 was $0.68 per share, or $56.4 million in total. Our return on average equity was 20.79% for the quarter ended June 30, 2003 and 23.08% for the quarter ended June 30, 2002. The decline in the return on average equity resulted from the declining interest rate spread.

For the six months ended June 30, 2003, our net income was $108.9 million, or $1.22 basic earnings per average share, as compared to $112.4 million, or $1.41 basic earnings per average share, for the six months ended June 30, 2002. We attribute the decrease in net income for the six month period ended June 30, 2003, over the six month period ended June 30, 2002, to the decline in the interest rate spread between the rate on interest-earning assets and the cost of funds for interest-bearing liabilities. We compute our net income per share by dividing net income by the weighted average number of shares of outstanding common stock during the period, which was 89,019,821 for the six months ended June 30, 2003 and 79,954,529 for the six months ended June 30, 2002. Dividends per shares outstanding for the six months ended June 30, 2003 was $1.20 per share, or $107.2 million in total. Dividends per shares outstanding for the six months ended June 30, 2002 was $1.31 per share, or $108.6 million in total. Our annualized return on average equity was 19.70% for the six months ended June 30, 2003 and 24.75% for the six months ended June 30, 2002.

Net Income Summary
(dollars in the thousands, except for per-share amounts)

| | Quarter Ended June 30, 2003 | Quarter Ended June 30, 2002 | Six Months Ended June 30, 2003 | Six Months Ended June 30, 2002 |
|---|---|---|---|---|
| Interest Income | $93,892 | $109,423 | $181,392 | $202,322 |
| Interest Expense | 51,770 | 47,860 | 95,818 | 87,872 |
| Net Interest Income | 42,122 | 61,563 | 85,574 | 114,450 |
| Gain on Sale of Investment Securities | 20,231 | 1,342 | 31252 | 4,752 |
| General and Administrative Expenses | 4,201 | 3,536 | 7,898 | 6,791 |
| Net Income | $58,152 | $59,369 | $108,928 | $112,412 |
| Weighted Average Number of Basic Shares Outstanding | 93,384,128 | 82,910,206 | 89,019,821 | 79,954,529 |
| Weighted Average Number of Diluted Shares Outstanding | 93,588,024 | 83,186,865 | 89,231,272 | 80,245,372 |
| Basic Net Income Per Share | $0.62 | $0.72 | $1.22 | $1.41 |
| Diluted Net Income Per Share | $0.62 | $0.71 | $1.22 | $1.40 |
| Average Total Assets | $13,692,434 | $10,717,867 | $13,014,651 | $9,717,683 |
| Average Equity | $1,119,075 | $1,029,064 | $1,106,072 | $908,495 |
| Annualized Return on Average Assets | 1.70% | 2.22% | 1.67% | 2.31% |
| Annualized Return on Average Equity | 20.79% | 23.08% | 19.70% | 24.75% |

Interest Income and Average Earning Asset Yield

We had average earning assets of $12.8 billion and $9.6 billion for the quarters ended June 30, 2003 and 2002, respectively. Our primary source of income for the quarters ended June 30, 2003 and 2002 was interest income. A portion of our income was generated by gains on the sales of our Investment Securities. Our interest income was $93.9 million for the quarter ended June 30, 2003 and $109.4 million for the quarter ended June 30, 2002. Our yield on average earning assets was 2.93% and 4.55% for the same respective periods. Our average earning asset balance increased by $3.2 billion and interest income decreased by $15.5 million for the quarter ended June 30, 2003 as compared to the quarter ended June 30, 2002, due to the substantial decline in the yield on interest-earning assets. The decline in the yield was the result of increased prepayment speeds and reduced coupons.

We had average earning assets of $11.8 billion and $8.6 billion for the six months ended June 30, 2003 and 2002, respectively. Our interest income was $181.4 million for the six months ended June 30, 2003 and $202.3 million for the six months ended June 30, 2002. Our yield on average earning assets was 3.07% and 4.69% for the same respective periods. Our average earning asset balance increased by $3.2 billion and interest income decreased by $20.9 million for the six months ended June 30, 2003 as compared to the six months ended June 30, 2002. Average earning asset increased due to the increased equity base from the equity offering in the 2nd quarter of 2003. The table below shows our average balance of cash equivalents and Investment Securities, the yields we earned on each type of earning asset, our yield on average earning assets and our interest income for the quarter ended June 30, 2003, March 31, 2003, the year ended December 31, 2002 and each of the four quarters in 2002.

Average Earning Asset Yield

(dollars in thousands)

(ratios for the quarters have been annualized)

| | Average Cash Equivalents | Average Investment Securities | Average Earning Assets | Yield on Average Cash Equivalents | Yield on Investment Securities | Yield on Average Interest Earning Assets | Interest Income |
|---|---|---|---|---|---|---|---|
| For the Quarter Ended June 30, 2003 | - | $12,815,290 | $12,815,290 | - | 2.93% | 2.93% | $93,892 |
| For the Quarter Ended March 31, 2003 | - | $10,837,147 | $10,837,147 | - | 3.23% | 3.23% | $87,500 |
| For the Year Ended December 31, 2002 | $2 | $9,575,365 | $9,575,367 | 1.14% | 4.22% | 4.22% | $404,165 |
| For the Quarter Ended December 31, 2002 | $2 | $10,400,894 | $10,400,896 | 0.88% | 3.56% | 3.56% | $92,641 |
| For the Quarter Ended September 30, 2002 | $2 | $10,661,228 | $10,661,230 | 1.14% | 4.10% | 4.10% | $109,201 |
| For the Quarter Ended June 30, 2002 | $2 | $9,629,332 | $9,629,334 | 1.23% | 4.55% | 4.55% | $109,423 |
| For the Quarter Ended March 31, 2002 | $2 | $7,610,006 | $7,610,008 | 1.29% | 4.88% | 4.88% | $92,900 |

The constant prepayment rate ("CPR") on our Mortgage-Backed Securities for the quarters ended June 30, 2003 and 2002 was 44% and 25% respectively. CPR is an assumed rate of prepayment for our Mortgage-Backed Securities, expressed as an annual rate of prepayment relative to the outstanding principal balance of our Mortgage-Backed Securities. CPR does not purport to be either a historical description of the prepayment experience of our Mortgage-Backed Securities or a prediction of the anticipated rate of prepayment of our Mortgage-Backed Securities.

Principal prepayments had a negative effect on our earning asset yield for the quarters ended June 30, 2003 and 2002 because we adjust our rates of premium amortization and discount accretion monthly based upon the effective yield method, which takes into consideration changes in prepayment speeds.

Interest Expense and the Cost of Funds

We had average borrowed funds of $12.3 billion and total interest expense of $51.8 million for the quarter ended June 30, 2003. We had average borrowed funds of $9.1 billion and total interest expense of $47.9 million for the quarter ended June 30, 2002. Our average cost of funds was 1.68% for the quarter ended June 30, 2003 and 2.10% for the quarter ended June 30, 2002. The cost of funds rate decreased 0.42% and the average borrowed funds increased by $3.2 billion for the quarter ended June 30, 2003 when compared to the quarter ended June 30, 2002. Interest expense for the quarter increased 8% due to the large increase in the average repurchase balance.

We had average borrowed funds of $11.4 billion and total interest expense of $95.8 million for the six months ended June 30, 2003. We had average borrowed funds of $8.1 billion and total interest expense of $87.9 million for the six months ended June 30, 2002. Our average cost of funds was 1.68% for the six months ended June 30, 2003 and 2.16% for the six months ended June 30, 2002. The cost of funds rate decreased 0.48% and the average borrowed funds increased by $3.3 billion for the six months ended June 30, 2003 when compared to the six months ended June 30, 2002.

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 quarters ended June 30, 2003, March 31, 2003, the year ended December 31, 2002 and each of the four quarters in 2002.

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

| | Average Borrowed Funds | Interest Expense | Average Cost of Funds | Average One-Month LIBOR | Average Six-Month LIBOR | Average One-Month LIBOR Less Average Six-Month LIBOR | Average Cost of Funds Less Average One-Month LIBOR | Average Cost of Funds Less Average Six-Month LIBOR |
|---|---|---|---|---|---|---|---|---|
| For the Quarter Ended June 30, 2003 | $12,311,329 | $51,770 | 1.68% | 1.26% | 1.20% | 0.06% | 0.42% | 0.48% |
| For the Quarter Ended March 31, 2003 | $10,463,252 | $44,048 | 1.68% | 1.34% | 1.33% | 0.01% | 0.34% | 0.35% |
| For the Year Ended December 31, 2002 | $9,128,933 | $191,758 | 2.10% | 1.77% | 1.88% | (0.11%) | 0.33% | 0.22% |
| For the Quarter Ended December 31, 2002 | $10,097,676 | $49,874 | 1.98% | 1.57% | 1.55% | 0.02% | 0.41% | 0.43% |
| For the Quarter Ended September 30, 2002 | $10,122,840 | $54,012 | 2.13% | 1.82% | 1.82% | - | 0.31% | 0.31% |
| For the Quarter Ended June 30, 2002 | $9,102,992 | $47,860 | 2.10% | 1.85% | 2.11% | (0.26%) | 0.25% | (0.01%) |
| For the Quarter Ended March 31, 2002 | $7,192,222 | $40,012 | 2.23% | 1.85% | 2.06% | (0.21%) | 0.38% | 0.17% |

Our net interest income, which equals interest income less interest expense, totaled $42.1 million for the quarter ended June 30, 2003 and $61.6 million for the quarter ended June 30, 2002. Our net interest income decreased because of the decline in net interest spread. This decline in spread is the direct result of the low interest rate environment and the high prepayment speeds. Our net interest spread, which equals the yield on our average assets for the period less the average cost of funds for the period, was 1.25% for the quarter ended June 30, 2003 as compared to 2.45% for the quarter ended June 30, 2002. This 120 basis point decrease in spread income is reflected in the decrease in net interest income.

Our net interest income, which equals interest income less interest expense, totaled $85.6 million for the six months ended June 30, 2003 and $114.5 million for the six months ended June 30, 2002. Our net interest income declined for the six month period due to the large amount of prepayments and the lower interest rate environment. Our net interest spread, which equals the yield on our average assets for the period less the average cost of funds for the period, was 1.38% for the six months ended June 30, 2003 as compared to 2.54% for the six months ended June 30, 2002. This 116 basis point increase in spread income is reflected in the increase in net interest income.

The table below shows our average investment securities and cash equivalents, total interest income, interest expense, average repurchase agreements, average cost of funds, and net interest income for the quarters ended June 30, 2003, March 31, 2003, the year ended December 31, 2002, and each of the four quarters in 2002.

Net Interest Income
(dollars in thousands)
(ratios for the quarters have been annualized)

| | Average Investment Securities Held | Interest Income on Investment Securities | Average Cash Equivalents | Total Interest Income | Yield on Average Interest Earning Assets | Average Balance of Repurchase Agreements | Interest Expense | Average Cost of Funds | Net Interest Income |
|---|---|---|---|---|---|---|---|---|---|
| For the Quarter Ended June 30, 2003 | $12,815,290 | $93,892 | - | $93,892 | 2.93% | $12,311,329 | $51,770 | 1.68% | $42,122 |
| For the Quarter Ended March 31, 2003 | $10,837,147 | $87,500 | - | $87,500 | 3.23% | $10,463,251 | $44,048 | 1.68% | $43,452 |
| For the Year Ended December 31, 2002 | $9,575,365 | $404,165 | $2 | $404,165 | 4.22% | $9,128,933 | $191,758 | 2.10% | $212,407 |
| For the Quarter Ended December 31, 2002 | $10,400,894 | $92,641 | $2 | $92,641 | 3.56% | $10,097,676 | $49,874 | 1.98% | $42,767 |
| For the Quarter Ended September 30, 2002 | $10,661,228 | $109,201 | $2 | $109,201 | 4.10% | $10,122,840 | $54,012 | 2.13% | $55,189 |
| For the Quarter Ended June 30, 2002 | $9,629,332 | $109,423 | $2 | $109,423 | 4.55% | $9,102,992 | $47,860 | 2.10% | $61,563 |
| For the Quarter Ended March 31, 2002 | $7,610,006 | $92,900 | $2 | $92,900 | 4.88% | $7,192,222 | $40,012 | 2.23% | $52,888 |

Gains and Losses on Sales of Investment Securities

For the quarter ended June 30, 2003, we sold Mortgage-Backed Securities with an aggregate historical amortized cost of $1.6 billion for an aggregate gain of $20.2 million. For the quarter ended June 30, 2002, we sold Mortgage-Backed Securities with an aggregate historical amortized cost of $413.6 million for an aggregate gain of $1.3 million. The difference between the sale price and the historical amortized cost of our Mortgage-Backed Securities is a realized gain and increases income accordingly. We do not expect to sell assets on a frequent basis, but may from time to time sell existing assets to move into new assets, which our management believes might have higher risk-adjusted returns, or to manage our balance sheet as part of our asset/liability management strategy.

During the quarter ended June 30, 2003, we had $171.0 million of callable agency debentures called at par. There was no gain or loss associated with the call on the securities.

For the six months ended June 30, 2003, we sold Mortgage-Backed Securities with an aggregate historical amortized cost of $2.4 billion for an aggregate gain of $31.3 million. For the six months ended June 30, 2002, we sold Mortgage-Backed Securities with an aggregate historical amortized cost of $803.7 million for an aggregate gain of $4.8 million. The difference between the sale price and the historical amortized cost of our Mortgage-Backed Securities is a realized gain and increases income accordingly.

Credit Losses

We have not experienced credit losses on our Investment Securities to date. We have limited our exposure to credit losses on our Investment Securities by purchasing only securities issued or guaranteed by FNMA, FHLMC, GNMA and FHLB which, although not rated, carry an implied "AAA" rating.

General and Administrative Expense

General and administrative ("G&A") expenses were $4.2 million for the quarter ended June 30, 2003 and $3.5 million for the quarter ended June 30, 2002. G&A expenses as a percentage of average assets was 0.12% for the quarter ended June 30, 2003 and 0.13% for the quarter ended June 30, 2002, on an annualized basis. G&A expenses as a percentage of average equity was 1.50% and 1.37% on an annualized basis for the quarters ended June 30, 2003 and 2002, respectively. The Company is internally managed and continues to be a low-cost provider. Even though G&A expenses increased by $665,000 for the quarter ended June 30, 2003, when compared to the quarter ended June 30, 2002, G&A as a percentage of average assets decreased by one basis point.

GAExpenses and Operating Expense Ratios

(dollars in thousands)

| | Total GA Expenses | Total GA Expenses/Average Assets (annualized) | Total GA Expenses/Average Equity (annualized) |
|---|---|---|---|
| For the Quarter Ended June 30, 2003 | $4,201 | 0.12% | 1.50% |
| For the Quarter Ended March 31, 2003 | $3,697 | 0.12% | 1.37% |
| For the Year Ended December 31, 2002 | $13,963 | 0.13% | 1.43% |
| For the Quarter Ended December 31, 2002 | $3,904 | 0.13% | 1.44% |
| For the Quarter Ended September 30, 2002 | $3,268 | 0.12% | 1.22% |
| For the Quarter Ended June 30, 2002 | $3,536 | 0.13% | 1.37% |
| For the Quarter Ended March 31, 2002 | $3,255 | 0.14% | 1.55% |

Net Income and Return on Average Equity

Our net income was $58.2 million for the quarter ended June 30, 2003 and $59.4 million for the quarter ended June 30, 2002. Our return on average equity was 20.79% for the quarter ended June 30, 2003 and 23.08% for the quarter ended June 30, 2002. Our net income was $108.9 million for the six months ended June 30, 2003 and $112.4 million for the six months ended June 30, 2002. The decline in net interest income was only partially offset by the increase in gain on sale of securities. The table below shows our net interest income, gain on sale of Mortgage-Backed Securities and G&A expenses each as a percentage of average equity, and the return on average equity for the quarters ended June 30, 2003, March 31, 2003, the year ended December 31, 2002, and for each of the four quarters in 2002.

Components of Return on Average Equity

(Ratios for all quarters are annualized)

| | Net Interest Income/Average Equity | Gain on Sale of Mortgage-Backed Securities/Average Equity | GA Expenses/Average Equity | Return on Average Equity |
|---|---|---|---|---|
| For the Quarter Ended June 30, 2003 | 15.06% | 7.23% | 1.50% | 20.79% |
| For the Quarter Ended March 31, 2003 | 16.11% | 4.09% | 1.37% | 18.83% |
| For the Year Ended December 31, 2002 | 21.72% | 2.15% | 1.43% | 22.44% |
| For the Quarter Ended December 31, 2002 | 15.80% | 4.27% | 1.44% | 18.63% |
| For the Quarter Ended September 30, 2002 | 20.68% | 1.78% | 1.22% | 21.24% |
| For the Quarter Ended June 30, 2002 | 23.93% | 0.52% | 1.37% | 23.08% |
| For the Quarter Ended March 31, 2002 | 25.24% | 1.63% | 1.55% | 25.32% |

## Financial Condition

### Investment Securities

All of our Mortgage-Backed Securities at June 30, 2003 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 our Mortgage-Backed Securities were FHLMC, FNMA or GNMA mortgage pass-through certificates or collateralized mortgage obligations ("CMOs"), which carry an actual or implied "AAA" rating. We mark-to-market all of our earning assets at fair value.

All of our Federal Home Loan Bank Debentures are adjustable rate in nature, which carry an implied "AAA" rating. We mark-to-market all of our Federal Home Loan Bank Debentures at fair value.

We accrete discount balances as an increase in interest income over the life of discount Mortgage-Backed Securities and we amortize premium balances as a decrease in interest income over the life of premium Mortgage-Backed Securities. At June 30, 2003 and December 31, 2002, we had on our Statement of Financial Condition a total of $1.1 million and $664,000 respectively, of unamortized discount (which is the difference between the remaining principal value and current amortized cost of our Mortgage-Backed Securities acquired at a price below principal value) and a total of $323.9 million and $274.6 million, respectively, of unamortized premium (which is the difference between the remaining principal value and the current historical amortized cost of our Mortgage-Backed Securities acquired at a price above principal value).

We received mortgage principal repayments of $2.2 billion for the quarter ended June 30, 2003 and $864.9 million for the quarter ended June 30, 2002. Given our current portfolio composition, if mortgage principal prepayment rates were to increase over the life of our Mortgage-Backed Securities, all other factors being equal, our net interest income would decrease during the life of these Mortgage-Backed Securities as we would be required to amortize our net premium balance into income over a shorter time period. Similarly, if mortgage principal prepayment rates were to decrease over the life of our Mortgage-Backed Securities, all other factors being equal, our net interest income would increase during the life of these Mortgage-Backed Securities, as we would amortize our net premium balance over a longer time period.

The table below summarizes our Investment Securities at June 30, 2003, March 31, 2003, December 31, 2002, September 30, 2002, June 30, 2002, and March 31, 2002.

Investment Securities
(dollars in thousands)

| | Principal Value | Net Premium | Amortized Cost | Amortized Cost/Principal Value | Estimated Fair Value | Estimated Fair Value/Principal Value | Weighted Average Yield |
|---|---|---|---|---|---|---|---|
| At June 30, 2003 | $13,939,447 | $322,838 | $14,262,285 | 102.32% | $14,263,475 | 102.32% | 2.87% |
| At March 31, 2003 | $11,957,710 | $289,360 | $12,247,070 | 102.42% | $12,318,070 | 103.01% | 2.83% |
| At December 31, 2002 | $11,202,384 | $273,963 | $11,476,347 | 102.45% | $11,551,857 | 103.12% | 3.25% |
| At September 30, 2002 | $11,170,379 | $244,777 | $11,415,156 | 102.19% | $11,489,538 | 102.86% | 3.67% |
| At June 30, 2002 | $10,833,374 | $224,114 | $11,057,488 | 102.07% | $11,124,771 | 102.69% | 3.90% |
| At March 31, 2002 | $9,982,678 | $193,048 | $10,175,726 | 101.93% | $10,206,228 | 102.24% | 4.31% |

The tables below set forth certain characteristics of our Investment Securities. The index level for adjustable-rate Mortgage-Backed 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 Value | Weighted Average Coupon Rate | Weighted Average Index Level | Weighted Average Net Margin | Weighted Average Term to Next Adjustment | Weighted Average Lifetime Cap | Weighted Average Asset Yield | Principal Value at Period End as % of Total Investment Securities |
|---|---|---|---|---|---|---|---|---|
| At June 30, 2003 | $8,889,012 | 3.69% | 2.18% | 1.51% | 18 months | 9.70% | 2.47% | 63.77% |
| At March 31, 2003 | $7,716,248 | 3.93% | 2.31% | 1.62% | 13 months | 10.04% | 2.20% | 64.53% |
| At December 31, 2002 | $7,007,062 | 4.10% | 2.51% | 1.59% | 11 months | 10.37% | 2.33% | 62.55% |
| At September 30, 2002 | $7,583,147 | 4.37% | 2.80% | 1.57% | 10 months | 10.36% | 2.90% | 67.89% |
| At June 30, 2002 | $7,939,126 | 4.57% | 2.96% | 1.61% | 12 months | 10.46% | 3.17% | 73.28% |
| At March 31, 2002 | $7,248,832 | 4.94% | 3.25% | 1.69% | 16 months | 10.73% | 3.52% | 72.61% |

## Fixed-Rate Investment Security Characteristics

(dollars in thousands)

| | Principal Value | Weighted Average Coupon Rate | Weighted Average Asset Yield | Principal Value at Period End as % of Total Investment Securities |
|---|---|---|---|---|
| At June 30, 2003 | $5,050,434 | 5.97% | 3.58% | 36.23% |
| At March 31, 2003 | $4,241,462 | 6.53% | 3.98% | 35.47% |
| At December 31, 2002 | $4,195,322 | 6.76% | 4.78% | 37.45% |
| At September 30, 2002 | $3,587,232 | 6.95% | 5.29% | 32.11% |
| At June 30, 2002 | $2,894,248 | 7.09% | 5.91% | 26.72% |
| At March 31, 2002 | $2,733,846 | 7.01% | 6.40% | 27.39% |

At June 30, 2003 and December 31, 2002 we held Mortgage-Backed Securities with coupons linked to the one-month , six-month and 12-month LIBOR, six month average auction, 12-month cumulative average, six-month CD rate, one-year, two-year, three-year, and five-year Treasury indices.

## Adjustable-Rate Mortgage-Backed Securities by Index

June 30, 2003

| | One-Month LIBOR | Six-Month Libor | Twelve Month Libor | Six-Month Auction Average | 12-Month Moving Average | Six-Month CD Rate | 1-Year Treasury Index | 2-Year Treasury Index | 3-Year Treasury Index | 5-Year Treasury Index |
|---|---|---|---|---|---|---|---|---|---|---|
| Weighted Average Term to Next Adjustment | 1mo. | 31 mo. | 34 mo | 2mo. | 1 mo | 3 mo. | 23 mo. | 5 mo. | 18 mo. | 26 mo. |
| Weighted Average Annual Period Cap | 8.86% | 2.00% | 2.00% | 1.00% | None | 1.00% | 1.89% | 2.00% | 2.00% | 2.00% |
| Weighted Average Lifetime Cap at June 30, 2003 | 7.96% | 9.74% | 10.28% | 13.00% | 10.75% | 10.75% | 10.50% | 11.91% | 12.89% | 12.58% |
| Mortgage Principal Value as Percentage of Mortgage-Backed Securities at June 30, 2003 | 21.95% | 1.24% | 6.82% | 0.02% | 0.62% | 0.05% | 28.46% | 0.02% | 0.55% | 0.24% |

## Adjustable-Rate Mortgage-Backed Securities by Index

December 31, 2002

| | One-Month LIBOR | Six-Month LIBOR | Six-Month Auction Average | 12-Month Moving Average | Six-Month CD Rate | 1-Year Treasury Index | 2-Year Treasury Index | 3-Year Treasury Index | 5-Year Treasury Index |
|---|---|---|---|---|---|---|---|---|---|
| Weighted Average Term to Next Adjustment | 1 mo. | 41 mo. | 2 mo. | 1 mo. | 2 mo. | 22 mo. | 10 mo. | 20 mo. | 31 mo. |
| Weighted Average Annual Period Cap | None | 2.00% | 2.00% | None | 1.00% | 1.93% | 2.00% | 2.00% | 2.00% |
| Weighted Average Lifetime Cap at December 31, 2002 | 9.01% | 11.31% | 13.00% | 10.37% | 11.60% | 11.83% | 11.93% | 12.83% | 12.57% |
| Mortgage Principal Value as Percentage of Mortgage-Backed Securities at December 31, 2002 | 32.43% | 0.33% | 0.03% | 0.58% | 0.14% | 27.67% | 0.03% | 0.92% | 0.42% |

Borrowings

To date, our debt has consisted entirely of borrowings collateralized by a pledge of our Investment Securities. These borrowings appear on our statement of financial condition as repurchase agreements. At June 30, 2003, we had established uncommitted borrowing facilities in this market with twenty-four lenders in amounts, which we believe, are in excess of our needs. All of our Investment Securities are currently accepted as collateral for these borrowings. However, we limit our borrowings, and thus our potential asset growth, in order to maintain unused borrowing capacity and thus increase the liquidity and strength of our balance sheet.

For the quarter ended June 30, 2003, the term to maturity of our borrowings ranged from one day to three years, with a weighted average original term to maturity of 128 days. For the quarter ended June 30, 2002, the term to maturity of our borrowings ranged from one day to three years, with a weighted average original term to maturity of 181 days. At June 30, 2003, the weighted average cost of funds for all of our borrowings was 1.50% and the weighted average term to next rate adjustment was 93 days. At June 30, 2002, the weighted average cost of funds for all of our borrowings was 2.10% and the weighted average term to next rate adjustment was 139 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 Statement of Financial Condidtion 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 our Investment Securities could in most circumstances 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.

Stockholders' Equity

We use "available-for-sale" treatment for our Investment Securities; we carry these assets on our Statement of Financial Condition at estimated fair value rather than historical amortized cost. Based upon this "available-for-sale" treatment, our equity base at June 30, 2003 was $1.2 billion, or $12.35 per share. If we had used historical amortized cost accounting, our equity base at June 30, 2003 would have been $1.2 billion, or $12.34 per share. Our equity base at June 30, 2002 was $1.0 billion, or $12.65 per share. If we had used historical amortized cost accounting, our equity base at June 30, 2002 would have been $982.3 million, or $11.84 per share per share. During the second quarter ended June 30, 2003, the Company raised additional capital in the amount of approximately $151.3 million in a secondary offering.

With our "available-for-sale" accounting treatment, unrealized fluctuations in market values of assets do not impact our taxable income but rather are reflected on our Statement of Financial Condition by changing the carrying value of the asset and stockholders' equity under "Accumulated Other Comprehensive Income (Loss)." By accounting for our assets in this manner, we hope to provide useful information to stockholders and creditors and to preserve flexibility to sell assets in the future without having to change accounting methods.

As a result of this mark-to-market accounting treatment, our book value and book value per share are likely to fluctuate far more than if we used historical amortized cost accounting. As a result, comparisons with companies that use historical cost accounting for some or all of their balance sheet may not be meaningful. The table below shows unrealized gains and losses on the Investment Securities in our portfolio.

Unrealized Gains and Losses

(dollars in thousands)

| | At June 30, 2003 | At March 31, 2003 | At December 31, 2002 | At September 30, 2002 | At June 30, 2002 | At March 31, 2002 |
|---|---|---|---|---|---|---|
| Unrealized Gain | $51,208 | $98,768 | $90,507 | $93,254 | $75,832 | $46,894 |
| Unrealized Loss | (50,018) | (27,768) | (14,997) | (18,872) | (8,549) | (16,392) |
| Net Unrealized Gain | $1,190 | $71,000 | $75,510 | $74,382 | $67,283 | $30,502 |
| Net Unrealized Gain as % of Investment Securities Principal Value | 0.01% | 0.59% | 0.67% | 0.67% | 0.62% | 0.31% |
| Net Unrealized Gain as % of Investment Securities Amortized Cost | 0.01% | 0.59% | 0.67% | 0.65% | 0.61% | 0.30% |

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 decrease our equity base and 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. "Unrealized Net Gains on Available for Sale Securities" was $1.2 million, or 0.01% of the amortized cost of our Investment Securities at June 30, 2003. "Unrealized Net Gains on Available for Sale Securities" was $75.5 million or 0.67% of the amortized cost of our Investment Securities at December 31, 2002.

The table below shows our equity capital base as reported and on a historical amortized cost basis at June 30, 2003, March 31, 2003, December 31, 2002, September 30, 2002, June 30, 2002 and March 31, 2002. Issuances of common stock, the level of earnings as compared to dividends declared, and other factors influence our historical cost equity capital base. The reported equity capital base is influenced by these factors plus changes in the "Unrealized Net Gains (Losses) on Assets Available for Sale" account.

Stockholders' Equity
(dollars in thousands, except per share amounts)

| | Historical Amortized Cost Equity Base | Net Unrealized Gains (Losses) on Assets Available for Sale | Reported Equity Base (Book Value) | Historical Amortized Cost Equity Per Share | Reported Equity (Book Value) Per Share |
|---|---|---|---|---|---|
| At June 30, 2003 | $1,160,248 | $1,190 | $1,161,438 | $12.34 | $12.35 |
| At March 31, 2003 | $1,005,712 | $71,000 | $1,076,712 | $11.88 | $12.72 |
| At December 31, 2002 | $1,004,555 | $75,511 | $1,080,066 | $11.88 | $12.77 |
| At September 30, 2002 | $1,010,623 | $74,382 | $1,085,005 | $11.96 | $12.84 |
| At June 30, 2002 | $982,348 | $67,283 | $1,049,631 | $11.84 | $12.65 |
| At March 31, 2002 | $978,186 | $30,502 | $1,008,688 | $11.80 | $12.17 |

Leverage

Our debt-to-equity ratio at June 30, 2003 and June 30, 2002 was 10:5:1 and 8.8:1, respectively. We generally expect to maintain a ratio of debt-to-equity of between 12:1 and 8:1, 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 will 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 in time by the monthly reduction of the balance of our Investment 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. We seek attractive risk-adjusted stockholder returns while maintaining 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, although we have not done so to date, we may seek 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 agreements such as interest rate caps and interest rate swaps.

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. We will 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.

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 conformity 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 our qualified REIT assets, as defined in the Internal Revenue Code, are 100% and 100% of our total assets at June 30, 2003 and 2002, as compared to the Internal Revenue Code requirement that at least 75% of our total assets be qualified REIT assets. We also calculate that 100% of our revenue qualifies for the 75% source of income test, and 100% of our revenue qualifies for the 95% source of income test, under the REIT rules for the quarters ended June 30, 2003 and 2002. We also met all REIT requirements regarding the ownership of our common stock and the distribution of our net income. Therefore, as of June 30, 2003 and 2002, 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. 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. In addition, unless certain mortgage securitites 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 June 30, 2003 and 2002 we were in compliance with this requirement.

## ITEM. 3 QUANTITATIVE AND QUALITIATIVE DISCLOSURES ABOUT MARKET RISK

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 Investment 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 and other interest rate exchange contracts, in order to limit the effects of interest rates on our operations. If 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. To date, we have not purchased any hedging instruments.

Our profitability and the value of our portfolio 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 and 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 June 30, 2003 and various estimates regarding prepayment and all activities are made at each level of rate shock. Actual results could differ significantly from these estimates.

| Change in Interest Rate | Projected Percentage Change in Net Interest Income | Projected Percentage Change in Portfolio Value |
|---|---|---|
| -75 Basis Points | (3%) | 1% |
| -50 Basis Points | (7%) | 1% |
| -25 Basis Points | (3%) | 1% |
| Base Interest Rate | | |
| +25 Basis Points | 3% | (1%) |
| +50 Basis Points | 4% | (1%) |
| +75 Basis Points | 10% | (2%) |

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 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 June 30, 2003. 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. Mortgage-Backed Securities reflect estimated prepayments that were estimated based on analyses of broker estimates, the results of a prepayment model that we utilized and empirical data. Our management believes that these assumptions approximate actual experience and considers them reasonable; however, the interest rate sensitivity of our assets and liabilities in the table could vary substantially if different assumptions were used or actual experience differs from the historical experience on which the assumptions are based.

| | Within 3 Months | 4-12 Months | More than 1 Year to 3 Years | 3 Years and Over | Total |
|---|---|---|---|---|---|
| | | | (dollars in thousands) | | |
| Rate Sensitive Assets: | | | | | |
| Investment Securities | $3,338,475 | $1,156,597 | $3,117,542 | $6,326,833 | $13,939,447 |
| Rate Sensitive Liabilities: | | | | | |
| Repurchase Agreements | 10,587,309 | 335,447 | 1,239,577 | - | 12,162,333 |
| Interest rate sensitivity gap | ($7,248,834) | $821,150 | $1,877,965 | $6,326,833 | $1,777,114 |
| Cumulative rate sensitivity gap | ($7,248,834) | ($6,427,684) | ($4,549,719) | $1,777,114 | |
| Cumulative interest rate sensitivity gap as a percentage of total rate-sensitive assets | (52%) | (46%) | (33%) | 13% | |

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

## ITEM 4. CONTROLS AND PROCEDURES

As of June 30, 2003, an evaluation was performed under the supervision and with the participation of our management, including our Chairman of the board of directors, Chief Executive Officer and President and our Chief Financial Officer and Treasurer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on that evaluation, our management, including our Chairman of the board of directors, Chief Executive Officer and President and our Chief Financial Officer and Treasurer, concluded that our disclosure controls and procedures were effective as of June 30, 2003. There have been no significant changes in our internal controls or in other factors that could significantly affect internal controls subsequent to June 30, 2003.

Item 5. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

(a) The annual meeting of stockholders of Annaly Mortgage Management, Inc. was held on May 15, 2003.

(b) All Class I director nominees were elected.

(c) Certain matters voted upon at the meeting and the votes cast with the respect to such matters are as follows:

Proposals and Vote Tabulations

| Director | Votes Received | Votes Withheld | Broker Non-Votes |
|---|---|---|---|
| Spencer I. Browne | 79,488,752 | 685,637 | 0 |
| Wellington J. Denahan | 79,439,645 | 734,744 | 0 |

The continuing directors of the Company are Kevin P. Brady, Michael A.J. Farrell, Jonathan D. Green, John A. Lambiase, and Donnell A. Segalas.

Management Proposals

| | Votes Cast | | | |
|---|---|---|---|---|
| | For | Against | Abstain | Broker Non-votes |
| Approval of the appointment of independent auditors for 2003 | 79,684,382 | 272,503 | 217,504 | 0 |

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibit Index

| Exhibit Number | Exhibit Description |
|---|---|
| 31.1 | Certification of Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Chief Financial Officer, 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 Chief Executive Officer, 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification of Chief Financial Officer, 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

(b) Reports of Form 8-K

We filed a Form 8-K on April 4, 2003 with respect to our entering into a Underwriting Agreement with UBS Warburg LLC, Merrill Lynch, Pierce, Fenner & Smith Incorporated, and U.S. Bancorp Piper Jaffray Inc. as representatives of the several underwriters (collectively, the "Underwriters"), relating to the sale of 8,200,000 shares of common stock, par value $0.01 per share (the "Common Stock"), and the granting of an over-allotment option for an additional 1,100,700 shares of Common Stock to the Underwriters to fulfill over-allotments.

We filed a Form 8-K on April 29, 2003 for our press release dated April 25, 2003.

The following current report on Form 8-K was filed by the Company subsequent to the second quarter of 2003:

We filed a Form 8-K on July 28, 2003 for our press release dated July 28, 2003.

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 MORTGAGE MANAGEMENT, INC.

Dated: August 14, 2003 By:/s/ Michael A.J. Farrell

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

Dated: August 14, 2003 By:/s/ Kathryn F. Fagan

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

EXHIBIT 31.1

CERTIFICATION

I, Michael A.J. Farrell, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Annaly Mortgage Management, Inc. (the "registrant");

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: August 14, 2003

/s/ Michael A.J. Farrell

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Michael A.J. Farrell
Chairman of the Board of Directors, Chief Executive Officer, President and principal executive officer

EXHIBIT 31.2

CERTIFICATION

I, Kathryn F. Fagan, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Annaly Mortgage Management, Inc. (the "registrant");

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: August 14, 2003

/s/ Kathryn F. Fagan

Kathryn F. Fagan
Chief Financial Officer, Treasurer and Principal Financial Officer

EXHIBIT 32.1

ANNALY MORTGAGE MANAGEMENT, INC.
1211 AVENUE OF THE AMERICAS
SUITE 2902
NEW YORK, NEW YORK 10036

CERTIFICATION OF CHIEF EXECUTIVE
OFFICER REGARDING PERIODIC REPORT CONTAINING
FINANCIAL STATEMENTS

I, Michael A.J. Farrell, the Chairman of the Board of Directors, Chief Executive Officer, and President of Annaly Mortgage Management, Inc. (the "Company") in compliance with 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, hereby certify that, the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2003 (the "Report") filed with the Securities and Exchange Commission:

- fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Michael A.J. Farrell
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Michael A.J. Farrell

Chairman of the Board of Directors, Chief Executive Officer, and President

August 14, 2003

EXHIBIT 32.2

ANNALY MORTGAGE MANAGEMENT, INC.
1211 AVENUE OF THE AMERICAS
SUITE 2902
NEW YORK, NEW YORK 10036

CERTIFICATION OF CHIEF FINANCIAL
OFFICER REGARDING PERIODIC REPORT CONTAINING
FINANCIAL STATEMENTS

I, Kathryn F. Fagan, the Chief Financial Officer and Treasurer of Annaly Mortgage Management, Inc. (the "Company") in compliance with 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, hereby certify that, the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2003 (the "Report") filed with the Securities and Exchange Commission:

- o fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- o the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Kathryn F. Fagan
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Kathryn F. Fagan

Chief Financial Officer and Treasurer

August 14, 2003