



**Workers on Wall Street
Celebrating the
End of WWII**

Jubilant financial district workers swarm the intersection of Wall and Broad, clambering over the statue of George Washington in front of the Sub-Treasury building.

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**Annaly
Mortgage
Management,
Inc.**




**Annual Report
2002**

Our family crest and its motto "Prodesse non Nocere" are the trademarks of the Company. The description figuratively means 'Proceed without fear.' That symbolizes the confidence we try to instill in our investors. It is reinforced by years of reliable, consistent investment performance.






The year 2002 demonstrated Annaly's ability to generate consistent returns for shareholders. Our proven model of investing in liquid, high quality assets and accessing the capital markets through sequential, accretive stock offerings resulted in a year of record earnings and dividends.

Stockholders' Equity (dollars in thousands)

2000	2001	2002
		
\$135,642	\$667,357	\$1,080,066

Earnings Per Share

2000	2001	2002
		
\$1.18	\$2.23	\$2.68

Annaly Mortgage Management, Inc. owns and manages a portfolio of mortgage-backed securities. Our principal business objective is to generate net income for distribution to our stockholders from the spread between the interest income on our mortgage-backed securities and the costs of borrowing to finance them. We have elected to be taxed as a real estate investment trust (or REIT) under the Internal Revenue Code. We commenced operations on February 18, 1997. We are self-advised and self-managed.



Michael A. J. Farrell

Chairman,
President &
CEO



Wellington Denahan

Vice Chairman &
Chief Investment
Officer



Kathryn Fagan

Chief Financial
Officer &
Treasurer



Jennifer Stephens

Executive VP &
Corporate
Secretary

WAR GARDENS

FOR VICTORY



Victory Gardens

Everyone on the home front was encouraged to do their part to ease wartime economic hardships through simple, symbolic and patriotic messages. The call to plant a Victory Garden was answered by nearly 20 million Americans.

As we mark the end of another successful year, I think about the world of difference that exists from just two years ago. Looking back now, the United States was somewhat naïve about its vulnerability in the world, as well as the future prospects for globalization and the conflicts it would create. In many ways we were not unlike the U.S. in the late 1930s.

A year has passed since last year's annual meeting, and upon reflection I am struck by the contrast from other annual meetings. At the close of last year's annual meeting, a stately "greatest generation" veteran stood up at the last call for questions and nominated the entire Annaly management team for the "Distinguished Service Cross" for meritorious service. This gentleman, a retired officer of World War II who served under General Patton and a veteran of the "financial services wars" for the past 50 years, spoke eloquently of the discipline he noticed in our management style, our execution and our dedication to providing strong shareholder value through extremely difficult markets. As he spoke, it occurred to me that while it is easy for us to get caught up in the day-to-day battles in the commercial marketplace, we should stop to consider the lesson of this man who, in his eighties now, had a spark and appreciation for life derived from the uniquely broad experience of his generation.

I took his remarks back to the team that day, but his mark was left on me. During the course of the year we meet or speak with literally thousands of investors, and I like to think that we earn the respect of investors one at a time. This Annaly shareholder, Colonel Julian Risken, has a great deal to teach us all. I met with him for lunch a couple of times after the annual meeting—mostly because the "greatest generation" holds a special place in my heart—and here's what I learned from him: Appreciate what you have and live life to the fullest, regardless of the present hurdles. He recently retired from a large financial services firm after many years. Upon retiring, his first phone call was to the police commissioner of New York City to offer his services for the "home guard," to help protect the country from "those scoundrels" who would do harm to his beloved country and city. I don't think that we will see the Colonel watching daytime television from the front porch. After the terrible tragedy experienced on September 11, 2001, this man, in my mind, exemplifies the American spirit. His zeal and determination to take personal responsibility for making the world a better place clearly affect everything from his demeanor to his view of life.



Michael A. J. Farrell

The theme of this year's annual report is the celebration that was felt at the end of the Second World War. It is appropriate that we understand the relief that is expressed in the faces from the past. It is also important to listen to the voices of those who did their part, experienced so much in their lives and taught perspective to all of us.

In today's world there are many challenges. The political front has us involved in an ideological war with roots dating back over 20 years; this war will not end with a celebration in Times Square or with a signed declaration of peace on the deck of an aircraft carrier. The economic front is mired in cleaning up the excesses created in the late 1990s when everyone was "rich" and going to retire early, perhaps to the front porch that Colonel Risken eschewed. We believe we have carefully positioned the company to meet the expected and the unexpected global, political and economic challenges going forward. There is no doubt in my mind that America—and our company—will overcome and survive the many challenges it faces. When I walk into the office each day I feel the same energy that Colonel Risken exudes. It is a testament to the women and men that represent Annaly in its daily business affairs that our business model is as successful as it is. While many may question the resolve of today's Americans, I don't. We are a resourceful people, with a wonderful blend of diversity and heritage inside of us, unlike any other in history. Individuals like the Colonel remind me of it continually.

The highlights of 2002 will reflect record earnings of \$2.68 per share, a doubling in market capitalization to \$1.6 billion, the entry of the company into the Russell 1000 index and avoidance of many of the pitfalls that plague our competitors in the sector.

As regards Annaly, it is the ongoing relationship with investors that binds our commitment to the diligent pursuit of a sound business strategy. We work hard every day to fulfill this commitment, one shareholder at a time. Against the background of turbulence, terrorism, corporate governance issues, volatile interest rates and economic uncertainty, the NLY team deserved the symbolism of the Distinguished Service Medal offered by Colonel Risken.

Yes, America may have been naïve and distracted two years ago or 60 years ago, but it is not now. As evidenced by 2002's results, neither is the NLY team.

March 17, 2003



Annaly's team is experienced in Wall Street trading, management and operations, with a specialization in investing in mortgage-backed securities on a leveraged basis. Senior management founded and capitalized Annaly Mortgage Management in November 1996. Successfully completing a private placement in February 1997, an IPO in October 1997 and four secondary offerings from January 2001 through January 2002, Annaly has consistently generated double-digit returns for its shareholders. Annaly Mortgage Management's success and future growth prospects are based on the proven ability of its strong and seasoned management team to deliver excellent results in volatile markets.



The Annaly team

Left to right, seated: Wellington Denahan, Jennifer Stephens, Kathryn Fagan, Michael Farrell. Standing: Nancy Murtha, Annie Montoya, Isabel Gordillo, Konstantin Pavlov, Rose-Marie Lyght, Ronald Kazel, Alexandra Denahan, Jeremy Diamond, Martha Cobo, James Fortescue.



Rosie
The
Riveter

Helping to win the war were the 6 million women who worked at industrial jobs, ensuring American productivity and challenging traditional notions of women's capabilities. The sight of women outfitted in overalls and wielding industrial tools became an icon that was popularized in the 1942 song, "Rosie the Riveter," providing a nickname for all women who worked in wartime industries. "All the day long, whether rain or shine/ She's a part of the assembly line./ She's making history, working for victory/ Rosie the Riveter."

(dollars in thousands, except for per share data)	For the Year Ended December 31, 2002	For the Year Ended December 31, 2001	For the Year Ended December 31, 2000	For the Year Ended December 31, 1999	For the Year Ended December 31, 1998
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Statement of Operations Data:

Interest income	\$ 404,165	\$ 263,058	\$ 109,750	\$ 89,812	\$ 89,986
Interest expense	191,758	168,055	92,902	69,846	75,735
Net interest income	\$ 212,407	\$ 95,003	\$ 16,848	\$ 19,966	\$ 14,251
Gain on sale of mortgage-backed securities	21,063	4,586	2,025	454	3,344
General and administrative expenses (G&A expense)	13,963	7,311	2,286	2,281	2,106
Net income	\$ 219,507	\$ 92,278	\$ 16,587	\$ 18,139	\$ 15,489
Basic net income per average share	\$ 2.68	\$ 2.23	\$ 1.18	\$ 1.41	\$ 1.22
Diluted net income per average share	\$ 2.67	\$ 2.21	\$ 1.15	\$ 1.35	\$ 1.19
Dividends declared per share	\$ 2.67	\$ 1.75	\$ 1.15	\$ 1.38	\$ 1.21

Balance Sheet Data:

Mortgage-Backed Securities, net	\$11,551,857	\$ 7,575,379	\$ 1,978,219	\$ 1,437,793	\$ 1,520,289
Total assets	11,659,084	7,717,314	2,035,029	1,491,322	1,527,352
Repurchase agreements	10,163,174	6,367,710	1,628,359	1,338,296	1,280,510
Total liabilities	10,579,018	7,049,957	1,899,386	1,388,050	1,401,481
Stockholders' equity	1,080,066	667,357	135,642	103,272	125,871
Number of common shares outstanding	84,569,206	59,826,975	14,522,978	13,581,316	12,648,424

Other Data:

Average total assets	\$10,486,423	\$ 5,082,852	\$ 1,652,459	\$ 1,473,765	\$ 1,499,875
Average earning assets	9,575,365	4,682,780	1,564,491	1,461,254	1,461,791
Average borrowings	9,128,933	4,388,900	1,449,999	1,350,230	1,360,040
Average equity	978,107	437,376	117,727	117,685	131,265
Yield on interest earning assets	4.22%	5.62%	7.02%	6.15%	6.16%
Cost of funds on interest bearing liabilities	2.10%	3.83%	6.41%	5.17%	5.57%
Interest rate spread	2.12%	1.79%	0.61%	0.98%	0.59%

Annualized Financial Ratios:

Net interest margin (net interest income/average total assets)	2.03%	1.87%	1.02%	1.35%	0.95%
G&A expense as a percentage of average assets	0.13%	0.14%	0.14%	0.15%	0.14%
G&A expense as a percentage of average equity	1.43%	1.67%	1.94%	1.94%	1.60%
Return on average assets	2.09%	1.82%	1.00%	1.23%	1.03%
Return on average equity	22.44%	21.10%	14.09%	15.41%	11.80%

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Overview

We are a real estate investment trust that owns and manages a portfolio of mortgage-backed securities. Our principal business objective is to generate net income for distribution to our stockholders from the spread between the interest income on our mortgage-backed securities and the costs of borrowing to finance our acquisition of mortgage-backed securities.

Special Note Regarding Forward-Looking Statements

Certain statements contained in this annual 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 dif-

fer 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 that could cause actual results to differ from those contained in the forward-looking statements, see "Risk Factors." We do not undertake, and specifically disclaim any obligation, to publicly release the result of any revisions that 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.

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 accordance with accounting principles generally accepted in the United States of America. In preparing the financial statements, management is required to make various judgments, estimates and assumptions that affect the reported amounts. Changes in these estimates and assumptions could have a material effect on our financial statements. The following is a summary of our policies that is the 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 Mortgage-Backed 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

Net Income Summary

For the year ended December 31, 2002, our net income was \$219.5 million or \$2.68 basic earnings per average share, as compared to \$92.3 million or \$2.23 basic earnings per average share for the year ended December 31, 2001. For the year ended December 31, 2000, our net income was \$16.6 million, or \$1.18 basic earnings per average share. Net income per average share increased by \$0.45 and total net income increased by \$127.2 million. The increase in 2002 net income over 2001 is attributable to our acquisition of additional mortgage-backed securities using proceeds raised from our January 2002 public offering and Equity Shelf Program during the year and the increase in the interest rate spread between our interest-earning assets and our interest-bearing liabilities. The same is true for the increase in net income for the year 2001, when compared to the year 2000. We consummated three public offerings in the year 2001 and the interest rate spread increased. 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 82,044,141 for the year ended December 31, 2002, 41,439,631 for the year ended December 31, 2001, and 14,089,436 for the year ended December 31, 2000. Dividends per share for the year ended December 31, 2002 were \$2.67, or an aggregate of \$223.6 million. Dividends per share for the year ended December 31, 2001 were \$1.75 per share, or \$88.4 million in total. Dividends per share for the year ended December 31, 2000 were \$1.15 per share, or \$16.3 million in total. Our return on average equity was 22.44% for the year ended December 31, 2002, 21.10% for the year ended December 31, 2001, and 14.09% for the year ended December 31, 2000. The increase in return on equity in 2002 compared to 2001 is primarily due to the favorable interest rate environment. The table on the following page presents the net income summary for the years ended December 31, 2002, 2001, 2000, 1999, and 1998.

Net Income Summary

(dollars in thousands, except for per share data)	Year Ended December 31, 2002	Year Ended December 31, 2001	Year Ended December 31, 2000	Year Ended December 31, 1999	Year Ended December 31, 1998
Interest Income	\$ 404,165	\$ 263,058	\$ 109,750	\$ 89,812	\$ 89,986
Interest Expense	191,758	168,055	92,902	69,846	75,735
Net Interest Income	\$ 212,407	\$ 95,003	\$ 16,802	\$ 19,966	\$ 14,251
Gain on Sale of Mortgage-Backed Securities	21,063	4,586	2,025	454	3,344
General and Administrative Expenses	13,963	7,311	2,286	2,281	2,106
Net Income	\$ 219,507	\$ 92,278	\$ 16,587	\$ 18,139	\$ 15,489
Average Number of Basic Shares Outstanding	82,044,141	41,439,631	14,089,436	12,889,510	12,709,116
Average Number of Diluted Shares Outstanding	82,282,883	41,857,498	14,377,459	13,454,007	13,020,648
Basic Net Income Per Share	\$ 2.68	\$ 2.23	\$ 1.18	\$ 1.41	\$ 1.22
Diluted Net Income Per Share	\$ 2.67	\$ 2.21	\$ 1.15	\$ 1.35	\$ 1.19
Average Total Assets	\$10,486,423	\$ 5,082,852	\$ 1,652,459	\$ 1,473,765	\$ 1,499,875
Average Equity	978,107	437,376	117,727	117,685	131,265
Annualized Return on Average Assets	1.43%	1.82%	1.00%	1.23%	1.03%
Annualized Return on Average Equity	22.44%	21.10%	14.09%	15.41%	11.80%

Interest Income and Average Earning Asset Yield

We had average earning assets of \$9.6 billion for the year ended December 31, 2002. We had average earning assets of \$4.7 billion for the year ended December 31, 2001. We had average earning assets of \$1.6 billion for the year ended December 31, 2000. Our primary source of income for the years ended December 31, 2002, 2001, and 2000 was interest income. A portion of our income was generated by gains on the sales of our mortgage-backed securities. Our interest income was \$404.2 million for the year ended December 31, 2002, \$263.1 million for the year ended December 31, 2001, and \$109.8 million for the year ended December 31, 2000. Our yield on average earning assets was 4.22%, 5.62%, and 7.02% for the same respective periods. Our yield on average earning assets decreased by 1.40% and our average earning asset balance increased by \$4.9 bil-

lion for the year ended December 31, 2002, when compared to the prior year. Due to the increase in the asset base resulting from the inflow of capital from our public offering and Equity Shelf Program during the year ended December 31, 2002, interest income increased by \$141.1 million. Our yield on average earning assets decreased by 1.40% and our average earning asset balance increased by \$3.1 billion for the year ended December 31, 2001, when compared to the prior year. Due to the increase in assets resulting from the three public offerings during the year ended December 31, 2001, interest income increased by \$153.3 million. The table below shows our average balance of cash equivalents and mortgage-backed securities, the yields we earned on each type of earning assets, our yield on average earning assets and our interest income for the years ended December 31, 2002, 2001, 2000, and 1999, and 1998 the four quarters in 2002.

Average Earning Asset Yield

(dollars in thousands)	Average Cash Equivalents	Average Mortgage- Backed Securities	Average Earning Assets	Yield on Average Cash Equivalents	Yield on Average Mortgage- Backed Securities	Yield on Average Earning Assets	Interest Income
For the Year Ended December 31, 2002	\$ 2	\$ 9,575,365	\$ 9,575,367	1.14%	4.22%	4.22%	\$404,165
For the Year Ended December 31, 2001	\$ 2	\$ 4,682,778	\$ 4,682,780	3.25%	5.62%	5.62%	\$263,058
For the Year Ended December 31, 2000	\$263	\$ 1,564,228	\$ 1,564,491	4.18%	7.02%	7.02%	\$109,750
For the Year Ended December 31, 1999	\$221	\$ 1,461,033	\$ 1,461,254	4.10%	6.15%	6.15%	\$ 89,812
For the Year Ended December 31, 1998	\$ 2	\$ 1,461,789	\$ 1,461,791	4.32%	6.16%	6.16%	\$ 89,986
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

(ratios for the four quarters in 2002 are annualized)

The constant prepayment rate ("CPR") on our mortgage-backed securities for the year ended December 31, 2002 was 33%, for the year ended December 31, 2001 was 26%, and for the year ended December 31, 2000 was 11%. 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 years ended December 31, 2002, 2001, and 2000 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

Our largest expense is the cost of borrowed funds, primarily through repurchase agreements. We had average borrowed funds of \$9.1 billion for the year ended December 31, 2002, \$4.4 billion for the year ended December 31, 2001, and \$1.4 billion for the year ended December 31, 2000. Interest expense totaled \$191.8 million, \$168.1 million, and \$92.9 million for the years ended December 31, 2002, 2001, and 2000, respectively. Our average cost of funds was 2.10% for the year ended December 31, 2002, 3.83% for the year ended December 31, 2001, and 6.41% for the year ended December 31, 2000. The cost of funds rate decreased by 1.73% and the average borrowed funds increased by \$4.7 billion for the year ended December 31, 2002. Interest expense for the year ended December 31, 2002 increased \$23.7 million, from \$168.1 million to \$191.8 million. We increased our asset base by raising approximately \$379.5 million of additional capital in 2002. As a result, we increased the amounts borrowed under repurchase agreements. Consequently, the increased interest expense for the year 2002 is the result of our growth. The cost of funds rate decreased by 2.58% and the average borrowed funds increased by \$3.0 billion for the year ended December 31, 2001. Interest expense for the year ended December 31, 2001 increased \$75.2 million. We increased our asset base by raising approximately \$474.2 million of additional capital in 2001. Consequently, the increased interest expense for the year 2001 is the result of our growth.

Changes in our short-term cost of funds are expected to be closely correlated with changes in short-term LIBOR, although we have chosen to extend the maturity on a portion of our liabilities to three years. Our average cost of funds was 0.33% greater than average one-month LIBOR for the year ended December 31, 2002, and 0.22% greater than average six-month LIBOR. Our average cost of funds was 0.05% less than average one-month LIBOR for the year ended December 31, 2001, and 0.10% greater than average six-month LIBOR. Our average cost of funds was equal to average one-month LIBOR for the year ended December 31, 2000, and 0.25% less than average six-month LIBOR. During the year ended December 31, 2002, average one-month LIBOR, which was 1.77%, was 0.11% less than average six-month LIBOR, which was 1.88%. During the year ended December 31, 2001, average one-month LIBOR, which was 3.88%, was 0.15% greater than average six-month LIBOR, which was 3.73%. During the year ended December 31, 2000, average one-month LIBOR, which was 6.41%, was 0.25% lower than average six-month LIBOR, which was 6.66%. The table below shows our average borrowed funds and average cost of funds as compared to average one-month and average six-month LIBOR for the years ended December 31, 2002, 2001, 2000, 1999, 1998, and the four quarters in 2002.

Average Cost of Funds

(dollars in thousands)	Average Borrowed Funds	Interest Expense	Average Cost of Funds	Average One-Month LIBOR	Average Six-Month LIBOR	Average One-Month LIBOR Relative to Average Six-Month LIBOR	Average Cost of Funds Relative to Average One-Month LIBOR	Average Cost of Funds Relative to Average Six-Month LIBOR
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 Year Ended December 31, 2001	\$ 4,388,900	\$ 168,055	3.83%	3.88%	3.73%	0.15%	(0.05%)	0.10%
For the Year Ended December 31, 2000	\$ 1,449,999	\$ 92,902	6.41%	6.41%	6.66%	(0.25%)	—	(0.25%)
For the Year Ended December 31, 1999	\$ 1,350,230	\$ 69,846	5.17%	5.25%	5.53%	(0.28%)	(0.08%)	(0.36%)
For the Year Ended December 31, 1998	\$ 1,360,040	\$ 75,735	5.57%	5.57%	5.54%	0.03%	—	0.03%
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%

(Ratios for the four quarters in 2002 have been annualized)

Net Interest Income

Our net interest income, which equals interest income less interest expense, totaled \$212.4 million for the year ended December 31, 2002, \$95.0 million for the year ended December 31, 2001, \$16.8 million for the year ended December 31, 2000. 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 2.12% for the year ended December 31, 2002, which is a 0.33% increase over the prior year. The net interest spread for the year ended December 31, 2001 was 1.79%, as compared to 0.61% for the year ended December 31, 2000. Our net interest income increased by \$117.4 million for the year ended December 31, 2002 over the prior year. The increase in our balance sheet which resulted from our raising additional capital in 2002, along with the 0.33% increase in the interest rate spread. The substantial increase in our balance sheet in 2001 which resulted from our raising additional capital in that year,

along with the 1.18% increase in the interest rate spread, caused the \$78.2 million increase in net interest income. Net interest margin, which equals net interest income divided by average interest earning assets, was 2.03% for the year ended December 31, 2002, 1.87% for the year ended December 31, 2001, and 1.02% for the year ended December 31, 2000. The principal reason that net interest margin exceeded net interest spread is that average interest earning assets exceeded average interest bearing liabilities. A portion of our assets is funded with equity rather than borrowings.

The table on the following page shows our interest income by earning asset type, average earning assets by type, total interest income, interest expense, average repurchase agreements, average cost of funds, and net interest income for the years ended December 31, 2002, 2001, 2000, 1999, 1998, and the four quarters in 2002.

Net Interest Income

	Average Mortgage- Backed Securities Held	Interest Income on Mortgage- Backed 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 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 Year Ended December 31, 2001	\$ 4,682,778	\$263,058	\$ 2	\$263,058	5.62%	\$ 4,388,900	\$168,055	3.83%	\$ 95,003
For the Year Ended December 31, 2000	\$ 1,564,228	\$109,739	\$263	\$109,750	7.02%	\$ 1,449,999	\$ 92,902	6.41%	\$ 16,848
For the Year Ended December 31, 1999	\$ 1,461,033	\$ 89,801	\$221	\$ 89,812	6.15%	\$ 1,350,230	\$ 69,846	5.17%	\$ 19,966
For the Year Ended December 31, 1998	\$ 1,461,789	\$ 89,986	\$ 2	\$ 89,986	6.16%	\$ 1,360,040	\$ 75,735	5.57%	\$ 14,251
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

(Ratios for the four quarters in 2002 have been annualized)

Gains and Losses on Sales of Mortgage-Backed Securities

For the year ended December 31, 2002, we sold mortgage-backed securities with an aggregate historical amortized cost of \$2.1 billion for an aggregate gain of \$21.1 million. For the year ended December 31, 2001, we sold mortgage-backed securities with an aggregate historical amortized cost of \$1.2 billion for an aggregate gain of \$4.6 million. For the year ended December 31, 2000, we sold mortgage-backed securities with an aggregate historical amortized cost of \$487.8 million for an aggregate gain of \$2.0 million. The gain on sale of assets for the year ended December 31, 2002 increased by \$16.5 million over the prior year. We were able to take advantage to the appreciation in our portfolio, while maintaining a book value of \$12.77. The gain on sale of assets for the year ended December 31, 2001 increased by \$2.6 million over the prior year. Even though the gain for the year 2001 increased over the prior year, as a percentage of total income it declined. 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.

Credit Losses

We have not experienced credit losses on our mortgage-backed securities to date. We have limited our exposure to credit losses on our mortgage-backed securities by purchasing only securities, issued or guaranteed by Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association, or the Government National Mortgage Association, which, although not rated, carry an implied "AAA" rating. Under our capital investment policy, however, up to 25% of our securities could be rated "BBB" or better or if unrated, securities we deem to be of a quality "BBB" or better.

General and Administrative Expenses

General and administrative expenses ("G&A") were \$14.0 million for the year ended December 31, 2002, \$7.3 million for the year ended December 31, 2001, and \$2.3 million for the year ended December 31, 2000. G&A expenses as a percentage of average assets was 0.13%, 0.14%, and 0.14% for the years ended December 31, 2002, 2001, and 2000, respectively. G&A expense has increased proportionately with our increased capital base. Increases in salaries were the primary reason for the overall increase in G&A. In 2002, we paid aggregate salaries and bonuses of \$10.8 million compared to \$4.7 million in 2001. The staff increased to 15 employees by the end of 2002 from 10 employees at the end of 2001. G&A expenses in total were materially unchanged for the years ended December 31, 2001, and 2000. The table on the following page shows our total G&A expenses as compared to average assets and average equity for the years ended December 31, 2002, 2001, 2000, 1999, 1998, and the four quarters in 2002.

G&A Expenses and Operating Expense Ratios

(dollars in thousands)	Total G&A Expenses	Total G&A Expenses/Average Assets	Total G&A Expenses/Average Equity
For the Year Ended December 31, 2002	\$13,963	0.13%	1.43%
For the Year Ended December 31, 2001	\$ 7,311	0.14%	1.67%
For the Year Ended December 31, 2000	\$ 2,286	0.14%	1.94%
For the Year Ended December 31, 1999	\$ 2,281	0.15%	1.94%
For the Year Ended December 31, 1998	\$ 2,106	0.14%	1.60%
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%

(Ratios for the four quarters in 2002 have been annualized)

Net Income and Return on Average Equity

Our net income was \$219.5 million for the year ended December 31, 2002, \$92.3 million for the year ended December 31, 2001, and \$16.6 million for the year ended December 31, 2000. Our return on average equity was 22.44% for the year ended December 31, 2002, 21.1% for the year ended December 31, 2001, and 14.1% for the year ended December 31, 2000. Net income increased by \$127.2 million in the year 2002 over the previous year, due to the increased asset base and the increase in the average interest rate spread. The increase in net income for the year ended December 2001, as compared to the year ended December 31, 2000, is a direct result of growth

in our balance sheet following our three public offerings in 2001, as well as the favorable interest rate environment during the year 2001.

We were able to take advantage of appreciation in asset value in 2001. The gain on sale of securities increased by \$2.6 million for the year ended December 31, 2001, as compared to the prior year. 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 years ended December 31, 2002, 2001, 2000, 1999, and 1998, and for the four quarters in 2002.

Components of Return on Average Equity

	Net Interest Income/Average Equity	Gain on Sale of Mortgage-Backed Equity	G&A Expenses/Average Equity	Return on Average Equity
For the Year Ended December 31, 2002	21.72%	2.15%	1.43%	22.44%
For the Year Ended December 31, 2001	21.72%	1.05%	1.67%	21.10%
For the Year Ended December 31, 2000	14.31%	1.72%	1.94%	14.09%
For the Year Ended December 31, 1999	16.97%	0.38%	1.94%	15.41%
For the Year Ended December 31, 1998	10.85%	2.55%	1.60%	11.80%
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%

(Ratios for the four quarters in 2002 have been annualized)

Financial Condition

Mortgage-Backed Securities

All of our mortgage-backed securities at December 31, 2002, 2001, and 2000 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 CMOs, which carry an implied "AAA" rating. We mark-to-market all of our earning assets at liquidation 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 December 31, 2002, 2001, and 2000, we had on our balance sheet a total of \$664,000, \$2.1 million, and \$989,000, respectively, of unamortized dis-

count (which is the difference between the remaining principal value and current historical amortized cost of our mortgage-backed securities acquired at a price below principal value) and a total of \$274.6 million, \$139.4 million, and \$24.3 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 \$4.7 billion for the year ended December 31, 2002, \$1.7 billion for the year ended December 31, 2001, and \$168.5 million for the year ended December 31, 2000. The overall prepayment speed for the year ended December 31, 2002, 2001, 2000 was 33%, 27%, and 11%, respectively. During the quarter ended December 31, 2002, the prepayment speeds were the highest in our history at 43%. The result was record returns of principal for the year, relative to the asset size. The increase in prepayments in 2001 from 2000 was primarily

because we acquired more mortgage-backed securities following our three public offerings. Given our current portfolio composition, if mortgage principal prepayment rates were to increase over the life of our mortgage-backed securities, all other factors being equal, our net interest income would decrease during the life of these mortgage-backed securities as we would be required to amortize our net premium balance into income over a shorter time period. Similarly, if mortgage principal prepayment rates were to decrease over the life of our mortgage-backed securities, all other factors

being equal, our net interest income would increase during the life of these mortgage-backed securities as we would amortize our net premium balance over a longer time period.

The table below summarizes certain characteristics of our mortgage-backed securities at December 31, 2002, 2001, 2000, 1999, and 1998, September 30, 2002, June 30, 2002, and March 31, 2002.

Mortgage-Backed 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 December 31, 2002	\$11,202,384	\$273,963	\$11,476,347	102.45%	\$11,551,857	103.12%	3.25%
At December 31, 2001	\$ 7,399,941	\$ 137,269	\$ 7,537,210	101.86%	\$ 7,575,379	102.37%	4.41%
At December 31, 2000	\$ 1,967,967	\$ 23,296	\$ 1,991,263	101.18%	\$ 1,978,219	100.52%	7.09%
At December 31, 1999	\$ 1,452,917	\$ 22,444	\$ 1,475,361	101.54%	\$ 1,437,793	98.96%	6.77%
At December 31, 1998	\$ 1,502,414	\$ 24,278	\$ 1,526,692	101.62%	\$ 1,520,289	101.19%	6.43%
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 mortgage-backed 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 Mortgage-Backed 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 Mortgage-Backed Securities
At December 31, 2002	\$ 7,007,062	4.10%	2.51%	1.59%	11 months	10.37%	2.33%	62.55%
At December 31, 2001	\$ 5,793,250	5.90%	3.95%	1.95%	24 months	11.49%	3.87%	78.29%
At December 31, 2000	\$ 1,454,356	7.61%	5.76%	1.85%	15 months	11.47%	7.24%	73.90%
At December 31, 1999	\$ 951,839	7.33%	5.84%	1.49%	11 months	10.30%	7.64%	65.51%
At December 31, 1998	\$ 1,030,654	6.84%	5.18%	1.66%	12 months	10.63%	6.42%	68.60%
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 Mortgage-Backed Security Characteristics

(dollars in thousands)	Principal Value	Weighted Average Coupon Rate	Weighted Average Asset Yield	Principal Value as % of Total Mortgage-Backed Securities
At December 31, 2002	\$4,195,322	6.76%	4.78%	37.45%
At December 31, 2001	\$1,606,691	6.92%	6.33%	21.71%
At December 31, 2000	\$513,611	6.62%	6.68%	26.10%
At December 31, 1999	\$501,078	6.58%	7.01%	34.49%
At December 31, 1998	\$471,760	6.55%	6.47%	31.40%
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 December 31, 2002 we held mortgage-backed securities with coupons linked to the one-year, two-year, three-year, and five-year Treasury indices, one-month and one-year LIBOR, six-month Auction Average, twelve-month moving average and the six-month CD rate. At December 31, 2001

we held mortgage-backed securities with coupons linked to the one-year, three-year, and five-year Treasury indices, one-month and six-month LIBOR, six-month Auction Average, twelve-month moving average and the six-month CD rate.

Adjustable-Rate Mortgage-Backed Securities by Index

December 31, 2002	One-Month LIBOR	1-Year 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 Adjustment Frequency	1mo.	12 mo.	6 mo.	1 mo.	6 mo.	12 mo.	24 mo.	36 mo.	60 mo.
Weighted Average Term to Next Adjustment	1mo.	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%

Adjustable-Rate Mortgage-Backed Securities by Index

December 31, 2001	One-Month LIBOR	Six-Month LIBOR	Six-Month Auction Average	12-Month Moving Average	Six-Month CD Rate	1-Year Treasury Index	3-Year Treasury Index	5-Year Treasury Index
Weighted Average Adjustment Frequency	1mo.	6 mo.	6 mo.	12 mo.	6 mo.	12 mo.	36 mo.	60 mo.
Weighted Average Term to Next Adjustment	1mo.	55 mo.	2 mo.	11 mo.	2 mo.	33 mo.	16 mo.	33 mo.
Weighted Average Annual Period Cap	None	2.00%	0.50%	None	1.00%	1.98%	2.00%	1.96%
Weighted Average Lifetime Cap at December 31, 2001	9.09%	11.50%	12.53%	10.63%	11.40%	12.22%	13.08%	12.92%
Mortgage Principal Value as Percentage of Mortgage-Backed Securities at December 31, 2001	18.32%	0.13%	0.12%	1.06%	0.22%	56.20%	1.35%	0.89%

Adjustable-Rate Mortgage-Backed Securities by Index

December 31, 2000	One-Month LIBOR	Six-Month CD Rate	1-Year Treasury Index	3-Year Treasury Index	5-Year Treasury Index
Weighted Average Adjustment Frequency	1 mo.	6 mo.	12 mo.	36 mo.	60 mo.
Weighted Average Term to Next Adjustment	1 mo.	2 mo.	23 mo.	20 mo.	40 mo.
Weighted Average Annual Period Cap	None	1.00%	1.98%	2.00%	1.76%
Weighted Average Lifetime Cap at December 31, 2000	9.11%	11.37%	12.61%	13.24%	12.42%
Mortgage Principal Value as Percentage of Mortgage-Backed Securities at December 31, 2000	24.08%	1.21%	44.52%	2.97%	1.12%

Borrowings

To date, our debt has consisted entirely of borrowings collateralized by a pledge of our mortgage-backed securities. These borrowings appear on our balance sheet as repurchase agreements. At December 31, 2002, we had established uncommitted borrowing facilities in this market with 25 lenders in amounts, which we believe, are in excess of our needs. We believe that we have used approximately 57% of our uncommitted borrowing line. All of our mortgage-backed 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. At December 31, 2002, we had collateral in excess of the required haircut on our repurchase agreements in the amount of \$677.7 million.

For the year ended December 31, 2002, the term to maturity of our borrowings ranged from one day to three years, with a weighted average original term to maturity of 166 days at December 31, 2002. For the years ended December 31, 2001 and 2000, the term to maturity of our borrowings ranged from one day to three years, with a weighted average original term to maturity of 119 days at December 31, 2001, and 56 days at December 31, 2000. At December 31, 2002, the weighted average cost of funds for all of our borrowings was 1.72% and the weighted average term to next rate adjustment was 124 days. At December 31, 2001, the weighted average cost of funds for all of our borrowings was 2.18% and the weighted average term to next rate adjustment was 85 days. At December 31, 2000, the weighted average cost of funds for all of our borrowings was 6.55% and the weighted average term to next rate adjustment was 29 days. At December 31, 2001, the weighted average original term increased because of the use of three year repurchase agreements.

Liquidity

Liquidity, which is our ability to turn non-cash assets into cash, allows us to purchase additional mortgage-backed 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 mortgage-backed securities varies. Our balance sheet also generates liquidity on an on-going basis through mortgage principal repayments and net earnings held prior to payment as dividends. Should our needs ever exceed these on-going sources of liquidity plus the immediate sources of liquidity discussed above, we believe that our mortgage-backed 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 mortgage-backed securities; we carry these assets on our balance sheet at estimated market value rather than historical amortized cost. Based upon this "available-for-sale" treatment, our equity base at December 31, 2002 was \$1.1 billion, or \$12.77 per share. If we had used historical amortized cost accounting, our equity base at December 31, 2002 would have been \$1.0 billion, or \$11.88 per share. Our equity base at December 31, 2001 was \$667.4 million, or \$11.15 per share. If we had used historical amortized cost accounting, our equity base at December 31, 2001 would have been \$629.2 million, or \$10.52 per share. Our equity base at December 31, 2000 was \$135.6 million, or \$9.34 per share. If we had used historical amortized cost accounting, our equity base at December 31, 2000 would have been \$148.6 million, or \$10.24 per share.

Through the Equity Shelf Program, in which we sell shares from time-to-time at market prices, we raised approximately \$28.1 million in net proceeds and issued 1,484,100 shares during 2002. Also in 2002, 165,480 shares were purchased through our dividend reinvestment and share purchase plan, totaling approximately \$3.0 million. We also completed an offering of common stock in the first quarter issuing 23,000,000 shares, with aggregate net proceeds of approximately \$347.4 million. We completed three public offerings during the year ended December 31, 2001 in which we issued a total of 45,060,100 shares of common stock, and received aggregate net proceeds of approximately \$474.2 million.

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

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

The table below shows unrealized gains and losses on the mortgage-backed securities in our portfolio.

Unrealized Gains and Losses

(dollars in thousands)	At December 31,				
	2002	2001	2000	1999	1998
Unrealized Gain	\$ 90,507	\$ 53,935	\$ 3,020	\$ 1,531	\$ 3,302
Unrealized Loss	(14,997)	(15,766)	(16,064)	(39,100)	(9,706)
Net Unrealized Gain (Loss)	\$ 75,510	\$ 38,169	(\$13,044)	(\$37,569)	(\$6,404)
Net Unrealized Gain (Loss) as % of Mortgage-Backed Securities Principal Value	0.67%	0.52%	(0.66%)	(2.59%)	(0.43%)
Net Unrealized Gain (Loss) as % of Mortgage-Backed Securities Amortized Cost	0.67%	0.51%	(0.66%)	(2.54%)	(0.42%)

Unrealized changes in the estimated net market value of mortgage-backed securities have one direct effect on our potential earnings and dividends: positive marked-to-market changes increase our equity base and allow us to increase our borrowing capacity while negative changes tend to limit borrowing capacity under our capital investment policy. A very large negative change in the net market value of our mortgage-backed securities might impair our liquidity position, requiring us to sell assets with the likely result of realized losses upon sale. The net unrealized gains (loss) on available for sale securities was \$75.5 million, or 0.67% of the amortized cost of our mortgage-backed securities as of December 31, 2002, \$38.2 million, or 0.51% of the amortized cost of our

mortgage-backed securities as of December 31, 2001, and \$13.0 million, or 0.66% of the amortized cost of our mortgage-backed securities at December 31, 2000.

The table on the following page shows our equity capital base as reported and on a historical amortized cost basis at December 31, 2002, 2001, 2000, 1999, and 1998, and 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 "Net Unrealized Losses on Assets Available for Sale" account.

Stockholders' Equity

(dollars in thousands, except per share data)	Historical Amortized Cost Equity Base	Net Unrealized Gains on Assets Available for Sale	Reported Equity Base (Book Value)	Historical Amortized Cost Equity Per Share	Reported Equity (Book Value) Per Share
At December 31, 2002	\$1,004,555	\$ 75,511	\$1,080,066	\$11.88	\$12.77
At December 31, 2001	\$ 629,188	\$ 38,169	\$ 667,357	\$ 10.52	\$ 11.15
At December 31, 2000	\$ 148,686	(\$ 13,044)	\$ 135,642	\$ 10.24	\$ 9.34
At December 31, 1999	\$ 140,841	(\$ 37,569)	\$ 103,272	\$ 10.37	\$ 7.60
At December 31, 1998	\$ 132,275	(\$ 6,404)	\$ 125,871	\$ 10.46	\$ 9.95
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 December 31, 2002, 2001, and 2000 was 9.4:1, 9.5:1, and 12.0:1, respectively. We generally expect to maintain a ratio of debt-to-equity of between 8:1 and 12:1, although the ratio may vary from 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 over time by the monthly reduction of the balance of our mortgage-backed securities through principal repayments.

Asset/Liability Management and Effect of Changes in Interest Rates

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

We seek to manage the extent to which our net income changes as a function of changes in interest rates by matching adjustable-rate assets with variable-rate borrowings. In addition, 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 mortgage-backed securities by entering into interest rate agreements such as interest rate caps and interest rate swaps.

Changes in interest rates may also affect 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 accordance with GAAP and our dividends based upon our net income as calculated for tax purposes; in each case, our activities and balance sheet are measured with reference to historical cost or fair market value without considering inflation.

Other Matters

We calculate that our qualified Real Estate Investment Trust ("REIT") assets, as defined in the Internal Revenue Code, are 100.0% of our total assets at December 31, 2002, 2001, and 2000 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 its revenue qualifies for the 95% source of income test, under the REIT rules for the years ended December 31, 2002, 2001, and 2000. We also met all REIT requirements regarding the ownership of our common stock and the distribution of our net income. Therefore, as of December 31, 2002, 2001, and 2000 we believe that we qualified as a REIT under the Internal Revenue Code.

We at all times intend to conduct our business so as not to become regulated as an investment company under the Investment Company Act of 1940, as amended (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 securities represent all the certificates issued with respect to an underlying pool of mortgages, the mortgage-backed securities may be treated as securities separate from the underlying mortgage loans and, thus, may not be considered qualifying interests for purposes of the 55% requirement. We calculate that as of December 31, 2002, 2001, and 2000 we were in compliance with this requirement.

To the Board of Directors and Stockholders of
Annaly Mortgage Management, Inc.

We have audited the accompanying statements of financial condition of Annaly Mortgage Management, Inc. (the "Company") as of December 31, 2002 and 2001, and the related statements of operations, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2002. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2002 and 2001, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

New York, New York
February 26, 2003

(dollars in thousands)

December 31,

2002

2001

Assets

Cash and Cash Equivalents	\$ 726	\$ 429
Mortgage-Backed Securities – At fair value	11,551,857	7,575,379
Receivable for Mortgage-Backed Securities Sold	55,954	94,503
Accrued Interest Receivable	49,707	46,804
Other Assets	840	199
Total Assets	\$11,659,084	\$7,717,314

Liabilities and Stockholders' Equity

Liabilities:		
Repurchase agreements	\$ 10,163,174	\$6,367,710
Payable for Mortgage-Backed Securities purchased	338,691	627,064
Accrued interest payable	14,935	16,043
Dividends payable	57,499	35,896
Other liabilities	2,812	2,010
Accounts payable	1,907	1,234
Total liabilities	10,579,018	7,049,957
Stockholders' Equity:		
Common stock: par value \$.01 per share; 500,000,000 authorized, 84,569,206 and 59,826,975 shares issued and outstanding, respectively	846	598
Additional paid-in capital	1,003,200	623,986
Accumulated other comprehensive income	75,511	38,169
Retained earnings	509	4,604
Total stockholders' equity	1,080,066	667,357
Total Liabilities and Stockholders' Equity	\$11,659,084	\$ 7,717,314

See notes to financial statements.

(dollars in thousands, except for per share data)

Years Ended December 31,

2002

2001

2000

Interest Income:			
Mortgage-Backed Securities and cash equivalents	\$ 404,165	\$ 263,058	\$ 109,751
Interest Expense:			
Repurchase agreements	191,758	168,055	92,902
Net Interest Income	212,407	95,003	16,849
Gain on Sale of Mortgage-Backed Securities	21,063	4,586	2,025
General and Administrative Expenses	13,963	7,311	2,287
Net Income	219,507	92,278	16,587
Other Comprehensive Gain:			
Unrealized gain on available-for-sale securities	58,405	55,800	26,549
Less reclassification adjustment for gains included in net income	(21,063)	(4,586)	(2,025)
Other comprehensive gain	37,342	51,214	24,524
Total Comprehensive Income	\$ 256,849	\$ 143,492	\$ 41,111
Net Income Per Share:			
Basic	\$ 2.68	\$ 2.23	\$ 1.18
Diluted	\$ 2.67	\$ 2.21	\$ 1.15
Average Number of Shares Outstanding:			
Basic	82,044,141	41,439,631	14,089,436
Diluted	82,282,883	41,857,498	14,377,459

See notes to financial statements.

(dollars in thousands)	Common Stock Par Value	Additional Paid-in Capital	Comprehensive Income	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance, December 31, 1999	135	140,263		443	(37,569)	103,272
Net income	—	—	\$ 16,587	16,587	—	—
Other comprehensive income:						
Unrealized net gains on securities, net of reclassification adjustment	—	—	24,524	—	24,524	
Comprehensive income	—	—	\$ 41,111	—	—	41,111
Exercise of stock options	—	198		—	—	198
Proceeds from direct purchase	9	7,384		—	—	7,393
Dividends declared for the year ended December 31, 2000, \$1.15 per share	—	—		(16,333)	—	(16,333)
Balance, December 31, 2000	144	147,845		697	(13,045)	135,641
Net income	—	—	\$ 92,278	92,278	—	—
Other comprehensive income:						
Unrealized net gains on securities, net of reclassification adjustment	—	—	51,214	—	51,214	
Comprehensive income	—	—	\$143,492	—	—	143,492
Exercise of stock options	3	2,972		—	—	2,975
Shares exchanged upon exercise of stock options		(587)			—	(587)
Proceeds from direct purchase	—	142		—	—	142
Proceeds from secondary offerings	451	473,614		—	—	474,065
Dividends declared for the year ended December 31, 2001, \$1.75 per share	—	—		(88,371)	—	(88,371)
Balance, December 31, 2001	\$598	\$623,986		4,604	38,169	667,357
Net income	—	—	\$219,507	219,507	—	—
Other comprehensive income:						
Unrealized net gains on securities, net of reclassification adjustment	—	—	37,342	—	37,342	
Comprehensive income	—	—	\$256,849	—	—	256,849
Exercise of stock options	1	1,089		—	—	1,090
Shares exchanged upon exercise of stock options		(76)		—	—	(76)
Proceeds from direct purchase	2	3,007		—	—	3,009
Proceeds from secondary offerings	230	347,106		—	—	347,336
Proceeds from equity shelf program	15	28,088		—	—	28,103
Dividends declared for the year ended December 31, 2002, \$2.67 per share	—	—		(223,602)	—	(223,602)
Balance, December 31, 2002	\$846	\$1,003,200		\$509	\$75,511	\$1,080,066

See notes to financial statements

(dollars in thousands)

Years Ended December 31,

2002

2001

2000

Cash Flows From Operating Activities:

Net income	\$ 219,507	\$ 92,278	\$ 16,587
Adjustments to reconcile net income to net cash provided by operating activities:			
Amortization of mortgage premiums and discounts, net	106,198	36,865	2,647
Market value adjustment on long term repurchase agreement	1,204	986	-
Gain on sale of Mortgage-Backed Securities	(21,063)	(4,587)	(2,025)
Stock option expense	240	790	-
Increase in accrued interest receivable	(2,903)	(35,301)	(4,645)
(Increase) decrease in other assets	(641)	61	(62)
(Decrease) increase in accrued interest payable	(1,109)	7,729	1,631
Increase in other liabilities and accounts payable	673	950	120
Net cash provided by operating activities	302,106	99,771	14,253

Cash Flows From Investing Activities:

Purchase of Mortgage-Backed Securities	(11,079,561)	(8,194,215)	(952,738)
Proceeds from sale of Mortgage-Backed Securities	2,076,800	1,248,812	489,810
Principal payments on Mortgage-Backed Securities	4,728,666	1,685,874	168,517
Net cash used in investing activities	(4,274,095)	(5,259,529)	(294,411)

Cash Flows From Financing Activities:

Proceeds from repurchase agreements	87,463,924	49,773,650	14,196,953
Principal payments on repurchase agreements	(83,668,862)	(45,033,275)	(13,906,890)
Proceeds from exercise of stock options	774	1,597	199
Proceeds from direct equity offering	3,010	142	7,393
Proceeds from secondary offerings	375,439	474,065	-
Dividends paid	(201,999)	(56,105)	(17,456)
Net cash provided by financing activities	3,972,286	5,160,074	280,199

Net Increase in Cash and Cash Equivalents	297	316	41
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Cash and Cash Equivalents, Beginning of Year	429	113	72
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Cash and Cash Equivalents, End of Year	\$ 726	\$ 429	\$ 113
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Supplemental Disclosure of Cash Flow Information:

Interest paid	\$ 190,650	\$ 160,327	\$ 91,270
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Noncash Financing Activities:

Net change in unrealized loss on available-for-sale securities	\$ 37,342	\$ 51,214	\$ (24,524)
Dividends declared, not yet paid	\$ 57,499	\$ 35,896	\$ 3,631

See notes to financial statements.

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:

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

Mortgage-Backed Securities— 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").

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 Mortgage-Backed Securities until maturity, it may, from time to time, sell any of its Mortgage-Backed Securities as part of its overall management of its balance sheet. Accordingly, this flexibility requires the Company to classify all of its Mortgage-Backed 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 Mortgage-Backed 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 years ended December 31, 2002, 2001, and 2000.

Interest income is accrued based on the outstanding principal amount of the Mortgage-Backed 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.

Mortgage-Backed 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 Mortgage-Backed Securities transactions are determined on the specific identification basis.

Credit Risk— At December 31, 2002 and 2001, the Company has limited its exposure to credit losses on its portfolio of Mortgage-Backed Securities by only purchasing securities issued by Federal Home Loan Mortgage Corporation ("FHLMC"), Federal National Mortgage Association ("FNMA"), or Government National Mortgage Association ("GNMA"). The payment of principal and interest on the FHLMC and FNMA Mortgage-Backed Securities are guaranteed by those respective agencies and the payment of principal and interest on the GNMA Mortgage-Backed Securities are backed by the full-faith-and-credit of the U.S. government. At December 31, 2002 and 2001, all of the Company's Mortgage-Backed Securities have an implied "AAA" rating.

Repurchase Agreements— The Company finances the acquisition of its Mortgage-Backed 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 repurchase 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 generally accepted accounting principles 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." 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 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 December 31, 2002, which are carried at their fair value:

(dollars in thousands)	Federal Home Loan Mortgage Corporation	Federal National Mortgage Association	Government National Mortgage Association	Total Mortgage- Backed Securities
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 following table pertains to the Company's Mortgage-Backed Securities classified as available-for-sale as of December 31, 2001, which are carried at their fair value:

(dollars in thousands)	Federal Home Loan Mortgage Corporation	Federal National Mortgage Association	Government National Mortgage Association	Total Mortgage-Backed Securities
Mortgage-Backed Securities, gross	\$ 4,426,195	\$2,894,026	\$ 79,720	\$ 7,399,941
Unamortized discount	(1,346)	(755)	—	(2,101)
Unamortized premium	83,775	54,118	1,477	139,370
Amortized cost	4,508,624	2,947,389	81,197	7,537,210
Gross unrealized gains	32,636	21,224	75	53,935
Gross unrealized losses	(7,986)	(7,314)	(466)	(15,766)
Estimated fair value	\$ 4,533,274	\$2,961,299	\$ 80,806	\$ 7,575,379
	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Estimated Fair Value
Adjustable Rate	\$5,908,236	\$ 44,469	\$(10,049)	\$5,942,656
Fixed Rate	1,628,974	9,466	(5,717)	1,632,723
Total	\$ 7,537,210	\$ 53,935	\$ (15,766)	\$ 7,575,379

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 8.8% and 11.5% at December 31, 2002 and 2001, respectively.

During the year ended December 31, 2002, the Company realized \$21.1 million in gains from sales of Mortgage-Backed Securities. During the year ended December 31, 2001, the Company realized \$6.8 million in gains from sales of Mortgage-Backed Securities. Losses totaled \$2.2 million for the year ended December 31, 2001. During the year ended December 31, 2000, the Company realized \$2.0 million in gains from sales of Mortgage-Backed Securities.

3. REPURCHASE AGREEMENTS

The Company had outstanding \$10,163,174,000 and \$6,367,710,000 of repurchase agreements with a weighted average borrowing rate of 1.72% and 2.18% and a weighted average remaining maturity of 124 days and 85 days as of December 31, 2002 and 2001, respectively. At December 31, 2002 and 2001, Mortgage-Backed Securities pledged had an estimated fair value of \$10,517,558,000 and \$6,564,250,000, respectively.

At December 31, 2002 and 2001 the repurchase agreements had the following remaining maturities:

(dollars in thousands)	2002	2001
Within 30 days	\$ 7,778,003	\$5,380,006
30 to 59 days	816,906	206,947
60 to 89 days	104,500	66,202
90 to 119 days	—	65,037
Over 120 days	1,463,765	649,518
	\$10,163,174	\$ 6,367,710

4. OTHER LIABILITIES

In 2001, the Company entered into a repurchase agreement maturing in July 2004, at which time, the repurchase agreement gives the buyer the right to extend, 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 \$1,200,000 allocated to the extension option 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 December 31, 2002, the fair value of this interest rate floor was a \$2,812,000 and was classified as other liabilities. The aggregate charge of \$1,204,000 and \$986,000 is included in interest expense for 2002 and 2001, respectively.

5. COMMON STOCK

During the Company's year ending 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, 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. Through the Equity Shelf Program, the Company raised \$28,103,000 in net proceeds and issued 1,481,000 shares. Also, 165,480 shares were purchased in dividend reinvestment and share purchase plan, totaling \$3,009,000. The Company completed an offering of common stock in the first quarter issuing 23,000,000 shares, with aggregate net proceeds of \$347.3 million.

During the Company's year ending December 31, 2001, the Company declared dividends to shareholders totaling \$88,370,451, or \$1.75 per share, of which \$52,474,266 was paid during the year and \$35,896,185 was paid on January 30, 2002. During the year ended December 31, 2001, 274,231 options were exercised at \$2,974,666. Total shares exchanged upon exercise of the stock options were 41,620 at a value of \$588,068. Also, 10,856 shares were purchased in dividend reinvestment and share purchase plan, totaling \$142,456. The Company completed an offering of

common stock in the third quarter issuing 14,991,600 shares, with aggregate net proceeds of \$179.6 million. An offering of common stock during the second quarter of 2001 was completed issuing 18,918,500 shares, with aggregate net proceeds of \$195.3 million. Additional offerings for 11,150,000 shares were completed during the first quarter for aggregate net proceeds of \$99.3 million.

During the Company's year ending December 31, 2000, the Company declared dividends to shareholders totaling \$16,333,252, or \$1.15 per share, of which \$12,702,507 was paid during the year

and \$3,630,745 was paid on January 30, 2001. During the year ended December 31, 2000, 47,499 options were exercised at \$198,762. Also, 894,163 shares were purchased in direct offerings, totaling \$7,392,859.

6. EARNINGS PER SHARE (EPS)

For the year ended December 31, 2002, the reconciliation is as follows:

For the Year Ended December 31, 2002 (dollars in thousands, except for per share data)	Income (Numerator)	Shares (Denominator)	Per Share Amount
Net income	\$219,507		
Basic EPS	219,507	82,044,141	\$2.68
Effect of dilutive securities:			
Dilutive stock options	—	238,742	
Diluted EPS	\$219,507	82,282,883	\$2.67

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 year.

For the year ended December 31, 2001, the reconciliation is as follows:

For the Year Ended December 31, 2001 (dollars in thousands, except for per share data)	Income (Numerator)	Shares (Denominator)	Per Share Amount
Net income	\$92,278		
Basic EPS	92,278	41,439,631	\$2.23
Effect of dilutive securities:			
Dilutive stock options	—	417,867	
Diluted EPS	\$92,278	41,857,498	\$2.21

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 year.

For the year ended December 31, 2000, the reconciliation is as follows:

For the Year Ended December 31, 2000 (dollars in thousands, except for per share data)	Income (Numerator)	Shares (Denominator)	Per Share Amount
Net income	\$16,587		
Basic EPS	16,587	14,089,436	\$1.18
Effect of dilutive securities:			
Dilutive stock options	—	288,023	
Diluted EPS	\$16,587	14,377,459	\$1.15

Options to purchase 568,926 shares of stock were outstanding and considered anti-dilutive. The exercise price exceeded the average stock price for the year.

7. 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 following table sets forth activity relating to the Company's stock options awards

	2002		2001		2000	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Options outstanding at the beginning of period	635,826	\$ 8.48	903,807	\$ 8.28	844,056	\$ 8.03
Granted	6,250	20.35	6,250	13.69	122,500	8.00
Exercised	(97,095)	8.75	(274,231)	7.95	(47,499)	4.18
Expired	(32,275)	8.28			(15,250)	9.17
Options outstanding at the end of period	512,706	\$ 8.59	635,826	\$ 8.48	903,807	\$ 8.28
Options exercisable at end of period	393,076	\$ 8.67	335,328	\$ 8.63	341,226	\$ 8.72

The following table summarizes information about stock options outstanding at December 31, 2002:

Range of Exercise Price	Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Yrs.)
\$7.94-\$19.99	506,456	8.44	6.5
\$20.00-\$29.99	6,250	20.35	4.5
	512,706	8.59	6.5

The Company accounts for the incentive plan under the intrinsic value method in accordance with APB Opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations. No stock-based employee compensation cost is reflected in net income, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date

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

For the Year Ended December 31, (dollars in thousands, except per share data)	2002	2001	2000
Net income, as reported	\$219,507	\$92,278	\$16,587
Deduct: Total stock-based employee compensation expense determined under fair value based method	(33)	(266)	(118)
Pro-forma net income	\$219,474	\$92,012	\$16,469
Net income per share, as reported			
Basic	\$ 2.68	\$ 2.23	\$ 1.18
Diluted	\$ 2.67	\$ 2.21	\$ 1.17
Pro-forma net income per share			
Basic	\$ 2.68	\$ 2.22	\$ 1.17
Diluted	\$ 2.67	\$ 2.20	\$ 1.15

The weighted average fair value at date of grant for stock options granted during the year ended December 31, 2002, 2001 and 2000 was \$0.83, \$0.89 and \$0.43 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	2000
Risk-free interest rate	4.02%	4.21%	5.16%
Expected option life in years	5	5	5
Expected stock price volatility	26%	28%	28%
Expected dividend yield	13.57%	15.32%	12.69%

8. COMPREHENSIVE INCOME

The Company adopted Statement of Financial Accounting Standards No. 130, Reporting Comprehensive Income. Statement 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 December 31, 2002 and 2001 held securities classified as available-for-sale. At December 31, 2002, the net unrealized gains totaled \$75,511,000 and at December 31, 2001, the net unrealized losses totaled \$38,169,000.

9. LEASE COMMITMENTS

The Corporation has a noncancelable lease for office space, which commenced in May 2002 and expires in December 2009.

The Corporation's aggregate future minimum lease payments are as follows:

Total per Year	(dollars in thousands)
2003	500
2004	500
2005	500
2006	530
2007	532
thereafter	1,064
Total remaining lease payments	\$3,626

10. RELATED PARTY TRANSACTION

Included in "Other Assets" on the Balance sheet as of December 31, 2001 is an investment in Annaly International Money Management, Inc. On June 24, 1998, the Company acquired 99,960 nonvoting shares, at a cost of \$49,980. Annaly International Money Management, Inc. was liquidated during the year, resulting in a \$44,000 loss, which is reflected in "Gain on Sale of Securities," in the Statement of Operations. The officers and directors of Annaly International Money Management Inc. are also officers and directors of the Company. Officers and employees of the Company are actively involved in managing Mortgage-Backed Securities and other fixed income assets for institutional clients through Fixed Income Discount Advisory Company ("FIDAC"). FIDAC is a registered investment adviser, which is owned 100% by the Chief Executive Officer of Annaly Mortgage Management, Inc. Our management currently allocates rent and other general and administrative expenses 90% to Annaly and 10% to FIDAC.

11. INTEREST RATE RISK

The primary market risk to the Company is interest rate risk. Interest rates are highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political considerations and other factors beyond the Company's control. Changes in the general level of interest rates can affect net interest income, which is the difference between the interest income earned on interest-earning assets and the interest expense incurred in connection with the interest-bearing liabilities, by affecting the spread between the interest-earning assets and interest-bearing liabilities. Changes in the level of interest rates also can affect the value of the 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.

12. SUMMARIZED QUARTERLY RESULTS (UNAUDITED)

The following is a presentation of the quarterly results of operations for the year ended December 31, 2002.

Quarters Ending (dollars in thousands)	March 31, 2002	June 30, 2002	September 30, 2002	December 31, 2002
Interest income from Mortgage-Backed Securities and cash	\$ 92,900	\$ 109,423	\$ 109,201	\$ 92,641
Interest expense on repurchase agreements	40,012	47,860	54,012	49,874
Net interest income	52,888	61,563	55,189	42,767
Gain on sale of Mortgage-Backed Securities	3,410	1,343	4,747	11,563
General and administrative expenses	3,255	3,536	3,268	3,904
Net income	\$ 53,043	\$ 59,370	\$ 56,668	\$ 50,426
Net income per share:				
Basic	\$ 0.69	\$ 0.72	\$ 0.68	\$ 0.60
Diluted	\$ 0.69	\$ 0.71	\$ 0.68	\$ 0.60
Average number of shares outstanding:				
Basic	76,709,836	82,910,206	83,668,422	84,525,171
Diluted	77,017,431	83,186,865	83,939,870	84,766,747

Quarters Ending (dollars in thousands)	March 31, 2001	June 30, 2001	September 30, 2001	December 31, 2001
Interest income from Mortgage-Backed Securities and cash	\$ 42,434	\$ 64,790	\$ 75,775	\$ 80,059
Interest expense on repurchase agreements	33,453	45,284	48,620	40,698
Net interest income	8,981	19,506	27,155	39,361
Gain on sale of Mortgage-Backed Securities	269	482	1,184	2,651
General and administrative expenses	921	1,393	1,993	3,004
Net income	\$ 8,329	\$ 18,595	\$ 26,346	\$ 39,008
Net income per share:				
Basic	\$ 0.38	\$ 0.48	\$ 0.58	\$ 0.65
Diluted	\$ 0.37	\$ 0.48	\$ 0.57	\$ 0.65
Average number of shares outstanding:				
Basic	21,851,481	38,473,928	45,503,179	59,776,777
Diluted	22,535,210	39,054,488	45,959,693	60,155,994

Quarters Ending (dollars in thousands)	March 31, 2000	June 30, 2000	September 30, 2000	December 31, 2000
Interest income from Mortgage-Backed Securities and cash	\$ 24,617	\$ 25,735	\$ 28,239	\$ 31,160
Interest expense on repurchase agreements	19,293	21,453	24,779	27,377
Net interest income	5,324	4,282	3,460	3,783
Gain on sale of Mortgage-Backed Securities	107	65	873	981
General and administrative expenses	582	507	527	670
Net income	\$ 4,849	\$ 3,840	\$ 3,806	\$ 4,094
Net income per share:				
Basic	\$ 0.35	\$ 0.27	\$ 0.27	\$ 0.28
Diluted	\$ 0.35	\$ 0.26	\$ 0.26	\$ 0.28
Average number of shares outstanding:				
Basic	13,660,539	14,039,741	14,238,680	14,413,578
Diluted	13,971,112	14,631,940	14,529,142	14,702,189

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

Stock Prices

	High	Low	Close	Cash Dividends Declared Per Share
First Quarter ended March 31, 2002	\$17.62	\$15.30	\$16.98	\$0.63
Second Quarter ended June 30, 2002	\$21.50	\$16.20	\$19.40	\$0.68
Third Quarter ended September 30, 2002	\$20.40	\$14.00	\$18.45	\$0.68
Fourth Quarter ended December 31, 2002	\$19.55	\$15.25	\$18.80	\$0.68
First Quarter ended March 31, 2001	\$11.50	\$ 8.75	\$11.26	\$0.30
Second Quarter ended June 30, 2001	\$13.76	\$10.50	\$13.71	\$0.40
Third Quarter ended September 30, 2001	\$14.93	\$12.70	\$14.45	\$0.45
Fourth Quarter ended December 31, 2001	\$17.01	\$13.20	\$16.00	\$0.60

We intend to pay quarterly dividends and to distribute to our stockholders all or substantially all of our taxable income in each year (subject to certain adjustments). This will enable us to qualify for the tax benefits accorded to a REIT under the Code. We have not established a minimum dividend payment level and our ability to pay dividends may be adversely affected for the reasons described under the caption "Risk Factors" in the 2002 Form 10-k. All distributions will be made at the discretion of our Board of Directors and will depend on our earnings, our financial condition, maintenance of our REIT status and such other factors as our Board of Directors may deem relevant from time to time.

Corporate Officers

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

Wellington J. Denahan
*Vice Chairman &
 Chief Investment Officer*

Kathryn F. Fagan
*Chief Financial Officer
 & Treasurer*

Jennifer A. Stephens
*Executive Vice President
 & Corporate Secretary*

James P. Fortescue
Senior Vice President

Kristopher R. Konrad
Senior Vice President

Rose-Marie Lyght
Vice President

Jeremy Diamond
Executive Vice President

Ronald D. Kazel
Senior Vice President

Board of Directors

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

Wellington J. Denahan
*Vice Chairman &
 Chief Investment Officer*

Kevin P. Brady
*Founder & Principal
 KPB Associates*

Spencer I. Browne
*Former President & Chief
 Executive Officer
 Asset Investors Corporation*

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

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

Donnell A. Segalas
Phoenix Investment Partners, Ltd.

Corporate Headquarters

Annaly Mortgage Management, Inc.
 1211 Avenue of the Americas, Suite 2902
 New York, New York 10036

Legal Counsel

McKee Nelson LLP
 1919 M. Street, NW
 Suite 800
 Washington, D.C. 20036

Auditors

Deloitte & Touche L.L.P.
 Two World Financial Center
 New York, New York 10281-1434

Stock Transfer Agent

Shareholder inquiries concerning dividend payments, lost certificates, change of address:

Mellon Investors Services, L.L.C.
 PO Box 3315
 South Hackensack, New Jersey
 07606-1163
www.mellon-investor.com

Stock Exchange Listing

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

Annual Meeting

The Annual Meeting of Stockholders will be held Thursday, May 15, 2003 at 10:30 am at:
 The Union League Club
 38 East 37th Street
 New York, New York 10178

Shareholder Communications

Copies of the Company's Annual Report and Financials may be obtained by writing the Corporate Secretary, by calling the investor relations hot line at 888-8ANNALY, or by visiting our website www.annaly.com.

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**Annaly
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**1211 Avenue of the Americas
Suite 2902
New York, New York 10036**

**1.888.8ANNALY
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