

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

CHIMERA INVESTMENT CORP
Form 10-Q
August 08, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED: JUNE 30, 2008

OR

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

FOR THE TRANSITION PERIOD FROM _____ TO _____

COMMISSION FILE NUMBER: 1-13447

CHIMERA INVESTMENT CORPORATION
(Exact name of Registrant as specified in its Charter)

MARYLAND 26-0630461
(State or other jurisdiction of (IRS Employer Identification No.)
incorporation or organization)

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

10036
(Zip Code)

(646) 454-3759
(Registrant's telephone number, including area code)

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

Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer
Smaller reporting company

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

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

| Class | Outstanding at August 8, 2008 |
|-------------------------------|-------------------------------|
| Common Stock, \$.01 par value | 38,992,543 |

CHIMERA INVESTMENT CORPORATION

FORM 10-Q

TABLE OF CONTENTS

Part I. FINANCIAL INFORMATION

Item 1. Financial Statements:

Consolidated Statements of Financial Condition at June 30, 2008 (Unaudited) and December 31, 2007 (Derived from the audited statement of financial condition at December 31, 2007) 1

Consolidated Statements of Operations and Comprehensive Loss for the Quarter and Six Months ended June 30, 2008 (Unaudited) 2

Consolidated Statement of Stockholders' Equity for the Quarters Ended March 31, 2008 and June 30, 2008 (Unaudited) 3

Consolidated Statements of Cash Flows for the Quarter and Six Months ended June 30, 2008 (Unaudited) 4

Notes to Consolidated Financial Statements (Unaudited) 6

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations 18

Item 3. Quantitative and Qualitative Disclosures about Market Risk 36

Item 4. Controls and Procedures 41

Part II. OTHER INFORMATION

Item 1. Legal Proceedings 41

Item 1A. Risk Factors 41

Item 4. Submission of Matters to a Vote of Security Holders 43

Item 6. Exhibits 44

SIGNATURES 45

i

PART I.

ITEM 1. FINANCIAL STATEMENTS

CHIMERA INVESTMENT CORPORATION
 CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
 (dollars in thousands, except per share data)

| | June 30, 2008 (unaudited) | December 31, 2007 (1) |
|---|------------------------------|--------------------------|
| | ----- | ----- |
| ASSETS | | |
| ----- | | |
| Cash and cash equivalents | \$ 49,889 | \$ 6,026 |
| Restricted cash | 29,507 | 1,350 |
| Reverse repurchase agreements | - | 265,000 |
| Mortgage-Backed Securities, at fair value | 1,116,586 | 1,124,290 |
| Loans held for investment, net of allowance for loan losses of \$546 and \$81, respectively | 150,083 | 162,371 |
| Securitized loans held for investment, net of allowance for loan losses of \$698 thousand | 613,580 | - |
| Accrued interest receivable | 9,863 | 6,036 |
| Other assets | 1,648 | 563 |
| | ----- | ----- |
| Total assets | \$ 1,971,156 | \$ 1,565,636 |
| | ===== | ===== |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| ----- | | |
| Liabilities: | | |
| Repurchase agreements | \$ 909,089 | \$ 270,584 |
| Securitized debt | 504,397 | - |
| Payable for investments purchased | 146,824 | 748,920 |
| Accrued interest payable | 3,518 | 415 |
| Dividends payable | 6,044 | 943 |
| Accounts payable and other liabilities | 3,540 | 1,729 |
| Interest rate swaps, at fair value | 10,065 | 4,156 |
| | ----- | ----- |
| Total liabilities | 1,583,477 | 1,026,747 |
| | ----- | ----- |
| Commitments and Contingencies (Note 14) | | |
| Stockholders' Equity: | | |
| Common stock: par value \$.01 per share; 500,000,000 shares authorized, 38,999,850 and 37,705,563 shares issued and outstanding, respectively | 378 | 377 |
| Additional paid-in capital | 533,026 | 532,208 |
| Accumulated other comprehensive (loss) income | (104,980) | 10,153 |
| Accumulated deficit | (40,745) | (3,849) |
| | ----- | ----- |

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

| | | |
|--|--------------|--------------|
| Total stockholders' equity | 387,679 | 538,889 |
| | ----- | ----- |
| Total liabilities and stockholders' equity | \$ 1,971,156 | \$ 1,565,636 |
| | ===== | ===== |

(1) Derived from the audited statement of financial condition at December 31, 2007.
See notes to consolidated financial statements.

1

CHIMERA INVESTMENT CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS
(dollars in thousands, except per share data)
(unaudited)

| | For the Quarter Ended June 30, 2008 | For the Six Months Ended June 30, 2008 |
|--|---|--|
| | ----- | ----- |
| Interest income | \$ 29,951 | \$ 58,145 |
| Interest expense | 20,025 | 34,047 |
| | ----- | ----- |
| Net interest income | 9,926 | 24,098 |
| | ----- | ----- |
| Unrealized gains (losses) on interest rate swaps | 25,584 | (5,909) |
| Realized gains (losses) on sales of investments | 1,644 | (31,174) |
| Realized gains on terminations of interest rate swaps | 123 | 123 |
| | ----- | ----- |
| Net investment income (loss) | 37,277 | (12,862) |
| | ----- | ----- |
| Other expenses | | |
| Management fee | 2,228 | 4,455 |
| General and administrative expenses | 1,152 | 3,719 |
| | ----- | ----- |
| Total expenses | 3,380 | 8,174 |
| | ----- | ----- |
| Income (loss) before income taxes | 33,897 | (21,036) |
| Income tax | - | 3 |
| | ----- | ----- |
| Net income (loss) | \$ 33,897 | \$ (21,039) |
| | ===== | ===== |
| Net income (loss) per share - basic and diluted | \$ 0.87 | \$ (0.54) |
| | ===== | ===== |
| Weighted average number of shares outstanding - basic and diluted | 38,999,850 | 38,995,096 |
| | ===== | ===== |

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

| | | |
|--|-------------|--------------|
| Comprehensive Loss: | | |
| Net income (loss) | 33,897 | (21,039) |
| | ----- | ----- |
| Other comprehensive loss: | | |
| Unrealized loss on available-for-sale securities | (58,051) | (136,154) |
| Reclassification adjustment for realized (gains) losses included in net income | (1,644) | 31,174 |
| | ----- | ----- |
| Other comprehensive loss | (59,695) | (104,980) |
| | ----- | ----- |
| Comprehensive loss | \$ (25,798) | \$ (126,019) |
| | ===== | ===== |

See notes to consolidated financial statements.

2

CHIMERA INVESTMENT CORPORATION
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(dollars in thousands, except per share data)
(unaudited)

| | Common Stock Par Value | Additional Paid-in Capital | Accumulated Other Comprehensive Income (Loss) | Accumulated Deficit | Total |
|---|---------------------------|----------------------------------|--|------------------------|------------|
| Balance, January 1, 2008 | \$ 377 | \$ 532,208 | \$ 10,153 | \$ (3,849) | \$ 538,889 |
| Net loss | - | - | - | (54,935) | (54,935) |
| Other comprehensive loss | - | - | (55,438) | - | (55,438) |
| Costs associated with common stock offering | - | (87) | - | - | (87) |
| Restricted stock grants | - | 697 | - | - | 697 |
| Common dividends declared, \$0.26 per share | - | - | - | (9,814) | (9,814) |
| Balance, March 31, 2008 | 377 | 532,818 | (45,285) | (68,598) | 419,312 |
| Net income | - | - | - | 33,897 | 33,897 |
| Other comprehensive loss | - | - | (59,695) | - | (59,695) |
| Costs associated with common stock offering | - | (129) | - | - | (129) |
| Restricted stock grants | 1 | 337 | - | - | 338 |
| Common dividends declared, \$0.16 per share | - | - | - | (6,044) | (6,044) |
| Balance, June 30, 2008 | \$ 378 | \$ 533,026 | \$ (104,980) | \$ (40,745) | \$ 378,389 |

See notes to consolidated financial statements.

CHIMERA INVESTMENT CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in thousands)
(unaudited)

| | For the Quarter Ended June 30, 2008 | For the Six Months Ended June 30, 2008 |
|--|---|--|
| Cash Flows From Operating Activities: | | |
| Net income (loss) | \$ 33,897 | \$ (21,039) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Amortization of investment premiums and discounts | (318) | (933) |
| Unrealized (gains) losses on interest rate swaps | (25,584) | 5,909 |
| Realized (gains) losses on sale of investments | (1,644) | 31,174 |
| Allowance for loan losses | (15) | 1,164 |
| Restricted stock grants | 337 | 1,035 |
| Changes in operating assets | | |
| Decrease (increase) in accrued interest receivable | 345 | (5,526) |
| Increase in other assets | (756) | (1,085) |
| Changes in operating liabilities | | |
| Increase in accounts payable | 167 | 1,004 |
| Increase in accrued interest payable | 311 | 3,103 |
| Increase in other liabilities | 845 | 807 |
| Net cash provided by operating activities | 7,585 | 15,613 |
| Cash Flows From Investing Activities: | | |
| Mortgage-Backed securities portfolio: | | |
| Purchases | - | (1,228,572) |
| Sales | - | 248,014 |
| Principal payments | 53,922 | 103,112 |
| Loans held for investment portfolio: | | |
| Purchases | (258,800) | (588,411) |
| Sales | 90,733 | 90,733 |
| Principal payments | 15,086 | 21,943 |
| Securitized loans | | |
| Principal payments | 12,656 | 12,656 |
| Reverse repurchase agreements | - | 265,000 |
| Restricted cash | 73,327 | (28,157) |
| Net cash used in investing activities | (13,076) | (1,103,682) |
| Cash Flows From Financing Activities: | | |
| Proceeds from repurchase agreements | 13,165,133 | 18,613,326 |
| Payments on repurchase agreements | (13,695,578) | (17,974,821) |
| Proceeds from securitized debt | 515,903 | 515,903 |
| Payments on securitized debt | (11,504) | (11,504) |
| Costs associated with common stock offerings | (129) | (216) |
| Dividends paid | (9,814) | (10,756) |
| Net cash (used in) provided by financing activities | (35,989) | 1,131,932 |

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

| | | |
|--|-----------|-----------|
| Net (decrease) increase in cash and cash equivalents | (41,480) | 43,863 |
| Cash and cash equivalents at beginning of period | 91,369 | 6,026 |
| Cash and cash equivalents at end of period | \$ 49,889 | \$ 49,889 |

4

| | | |
|--|--------------|--------------|
| Supplemental disclosure of cash flow information | | |
| Interest paid | \$ 19,714 | \$ 30,944 |
| Taxes paid | \$ - | \$ 45 |
| Non cash investing activities | | |
| Receivable for investments sold | \$ (113,581) | \$ - |
| Payable for investments purchased | \$ 146,824 | \$ 146,824 |
| Net change in unrealized loss on available for sale securities | \$ (59,695) | \$ (104,980) |
| Non cash financing activities | | |
| Dividends declared, not yet paid | \$ 6,044 | \$ 6,044 |

See notes to consolidated financial statements.

5

CHIMERA INVESTMENT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE QUARTER ENDED JUNE 30, 2008

(dollars in thousands, except per share data)
(unaudited)

1. Organization and Significant Accounting Policies

Chimera Investment Corporation, or the Company, was organized in Maryland on June 1, 2007. The Company commenced operations on November 21, 2007 when it completed its initial public offering. The Company has elected to be taxed as a real estate investment trust, or REIT, under the Internal Revenue Code of 1986, as amended. As such, the Company is required to distribute substantially all of the income generated from its operations to its stockholders. As long as the Company qualifies as a REIT, the Company will generally not be subject to U.S. federal or state corporate taxes on its income to the extent that the Company distributes at least 90% of its taxable net income to its stockholders. The Company is managed by Fixed Income Discount Advisory Company, or FIDAC, an investment advisor registered with the Securities and Exchange Commission. FIDAC

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

is a wholly-owned subsidiary of Annaly Capital Management, Inc., or Annaly.

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

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in conformity with the instructions to Form 10-Q and Article 10, Rule 10-01 of Regulation S-X for interim financial statements. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America, or GAAP. The consolidated interim financial statements are unaudited; however, in the opinion of the Company's management, all adjustments, consisting only of normal recurring accruals, necessary for a fair presentation of the financial position, results of operations, and cash flows have been included. Comparative information for the quarter and six months ended June 30, 2007 is not provided because the Company did not commence operations until November 21, 2007. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2007. The nature of the Company's business is such that the results of any interim period are not necessarily indicative of results for a full year.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand and money market funds.

Restricted Cash

Restricted cash includes cash held by counterparties as collateral for repurchase agreements and interest rate swaps.

Reverse Repurchase Agreements

The Company may invest its daily available cash balances in reverse repurchase agreements to provide additional yield on its assets. These investments will typically be recorded as short term investments, will mature daily, and are referred to as reverse repurchase agreements in the statement of financial condition. Reverse repurchase agreements are recorded at cost and are collateralized by residential mortgage-backed securities, or RMBS.

Residential Mortgage-Backed Securities

The Company invests in RMBS representing interests in obligations backed by pools of mortgage loans and carries those securities at fair value estimated using a pricing model. Management will review the fair values generated to determine that prices are reflective of the current market. Management performs a validation of the fair value calculated by the pricing model by comparing its results to independent prices provided by dealers in the securities and/or third party pricing services. If dealers or independent pricing services are unable to provide a price for an asset, or if the price provided by them is deemed unreliable by FIDAC, then the asset will be valued at its fair value as determined in good faith by FIDAC. In the current market, it may be difficult or impossible to obtain third party pricing on the investments the Company purchases. In addition, validating third party pricing for the Company's investments may be more subjective as fewer participants may be willing to provide this service to the Company. Moreover, the current market is more illiquid than in recent history for some of the investments the Company purchases. Illiquid investments typically experience greater price volatility as a ready market does not exist. As volatility increases or liquidity decreases, the Company may have greater difficulty financing its investments which may negatively impact its earnings and the execution of its investment strategy.

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

Please see Note 5 for a discussion of fair value measurement.

6

Statement of Financial Accounting Standards, or SFAS, No. 115, Accounting for Certain Investments in Debt and Equity Securities, requires the Company to classify its investment securities as either trading investments, available-for-sale investments or held-to-maturity investments. The Company intends to hold its RMBS as available-for-sale and as such may sell any of its RMBS as part of its overall management of its portfolio. All assets classified as available-for-sale are reported at estimated fair value, with unrealized gains and losses included in other comprehensive income.

Management evaluates investment securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been lower than carrying value, (2) the financial condition and near-term prospects of the issuer, (3) credit quality and cash flow performance of the security, and (4) the intent and ability of the Company to retain its investment in the security for a period of time sufficient to allow for any anticipated recovery in fair value. Unrealized losses on investment securities that are considered other than temporary, as measured by the amount of decline in fair value attributable to other-than-temporary factors, are recognized in income and the cost basis of the investment securities is adjusted.

RMBS transactions are recorded on the trade date. Realized gains and losses from sales of RMBS are determined based on the specific identification method and recorded as a gain (loss) on sale of investments in the statement of operations. Accretion of discounts or amortization of premiums on available-for-sale securities and mortgage loans is computed using the effective interest yield method and is included as a component of interest income in the statement of operations.

Loans Held for Investment and Securitized Loans Held for Investment

The Company's securitized and un-securitized residential mortgage loans are comprised of fixed-rate and variable-rate loans. The Company purchases pools of residential mortgage loans through a select group of originators. Mortgage loans are designated as held for investment, recorded on trade date, and are carried at their principal balance outstanding, plus any premiums or discounts which are amortized or accreted over the estimated life of the loan, less allowances for loan losses. Loans are evaluated for possible credit losses. The Company has created an unallocated provision for loan losses estimated as a percentage of the remaining principal on the loans. Management's estimate is based on historical experience of similarly underwritten loan pools. There were no losses specifically allocated to loans as of June 30, 2008. Residential loan securitizations that are presented as securitized loans and securitized debt are reflected in the consolidated statements of financial position, and are accounted for as a financing pursuant to SFAS 140.

Allowance for Loan Losses

The Company has established an allowance for loan losses at a level that management believes is adequate based on an evaluation of known and inherent risks related to the Company's loan portfolio. The estimate is based on a variety of factors including, but not limited to, current economic conditions, industry loss experience, credit quality trends, loan portfolio composition, delinquency trends, national and local economic trends, national unemployment

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

data, changes in housing appreciation and whether specific geographic areas where the Company has significant loan concentrations are experiencing adverse economic conditions and events such as natural disasters that may affect the local economy or property values. Upon purchase of the pools of loans, the Company obtained written representations and warranties from the sellers that the Company could be reimbursed for the value of the loan if the loan fails to meet the agreed upon origination standards. While the Company has little history of its own to establish loan trends, delinquency trends of the originators and the current market conditions aid in determining the allowance for loan losses. The Company also performed due diligence procedures on a sample of loans that met its criteria during the purchase process.

7

When it is probable that contractually due specific amounts are deemed uncollectible, the loan is considered impaired. Where impairment is indicated, a valuation write-off is measured based upon the excess of the recorded investment over the net fair value of the collateral, reduced by selling costs. Any deficiency between the carrying amount of an asset and the net sales price of repossessed collateral is charged to the allowance for loan losses.

Securitized Debt

The Company has issued securitized debt to finance a portion of its residential mortgage loan portfolio. The securitized debt is collateralized by residential adjustable or fixed rate mortgage loans that have been placed in a trust and bear interest and principal payments to the debt holders. The Company's securitized debt is accounted for as borrowings and recorded as a liability on the consolidated statement of financial condition.

Fair Value Disclosure

SFAS No. 107, Disclosure About Fair Value of Financial Instruments, requires disclosure of the fair value of financial instruments for which it is practicable to estimate that value. The estimated fair value of investment securities and interest rate swaps is equal to their carrying value presented in the consolidated statements of financial condition. The estimated fair value of cash and cash equivalents, accrued interest receivable, reverse repurchase agreements, repurchase agreements with maturities shorter than one year, payables for mortgage-backed securities purchased, dividends payable, accounts payable, and accrued interest payable, generally approximates cost as of the dates presented due to the short term nature of these financial instruments. The fair value of repurchase agreements with longer dated maturities is generally approximated by cost as the loans reprice frequently to market rates.

Interest Income

Interest income on available-for-sale securities and loans held for investment is recognized over the life of the investment using the effective interest method as described by SFAS No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases, for securities of high credit quality and Emerging Issues Task Force No. 99-20, Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets, for all other securities. Income recognition is suspended for loans when, in the opinion of management, a full recovery of income and principal becomes doubtful. Income recognition is resumed when the loan becomes contractually current and performance is demonstrated to be resumed.

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

Derivative Financial Instruments/Hedging Activity

The Company economically hedges interest rate risk through the use of derivative financial instruments, currently limited to interest rate swaps. The Company accounts for these interest rate swaps as free-standing derivatives. Accordingly, they are carried at fair value with realized and unrealized gains and losses recognized in earnings.

Income Taxes

The Company intends to qualify to be taxed as a REIT, and therefore it generally will not be subject to corporate federal or state income tax to the extent that qualifying distributions are made to stockholders and the REIT requirements, including certain asset, income, distribution and stock ownership tests are met. If the Company failed to qualify as a REIT and did not qualify for certain statutory relief provisions, the Company would be subject to federal, state and local income taxes and may be precluded from qualifying as a REIT for the subsequent four taxable years following the year in which the REIT qualification was lost.

The Company accounts for income taxes in accordance with SFAS No. 109, Accounting for Income Taxes, which requires the recognition of deferred income taxes for differences between the basis of assets and liabilities for financial statement and income tax purposes. Deferred tax assets and liabilities represent the future tax consequence for those differences, which will either be taxable or deductible when the assets and liabilities are recovered or settled. Deferred taxes are also recognized for operating losses that are available to offset future taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized. In July 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in an income tax return. FIN 48 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 was effective for the Company upon inception and its effect was not material.

8

Net Income per Share

The Company calculates basic net income per share by dividing net income for the period by the weighted-average shares of its common stock outstanding for that period. Diluted net income per share takes into account the effect of dilutive instruments, such as stock options, but uses the average share price for the period in determining the number of incremental shares that are to be added to the weighted average number of shares outstanding. The Company had no potentially dilutive securities outstanding during the periods presented.

Stock-Based Compensation

The Company accounts for stock-based compensation in accordance with the provisions of SFAS No. 123R, Accounting for Stock-Based Compensation, which establishes accounting and disclosure requirements using fair value based methods of accounting for stock-based compensation plans. Compensation expense related to grants of stock and stock options is recognized over the vesting period of such grants based on the estimated fair value on the grant date.

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

Stock compensation awards granted to the employees of FIDAC are accounted for in accordance with EITF 96-18, Accounting For Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods and Services, which requires the Company to measure the fair value of the equity instrument using the stock prices and other measurement assumptions as of the earlier of either the date at which a performance commitment by the counterparty is reached or the date at which the counterparty's performance is complete.

Use of Estimates

The preparation of the financial statements in conformity with GAAP, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board, or FASB, issued SFAS No. 157, Fair Value Measurements, or SFAS 157. SFAS 157 defines fair value, establishes a framework for measuring fair value and requires enhanced disclosures about fair value measurements. SFAS 157 requires companies to disclose the fair value of their financial instruments according to a fair value hierarchy (i.e., levels 1, 2, and 3, as defined). Additionally, companies are required to provide enhanced disclosure regarding instruments in the level 3 category (which require significant management judgment), including a reconciliation of the beginning and ending balances separately for each major category of assets and liabilities. SFAS 157 was adopted by the Company on January 1, 2008. SFAS 157 did not significantly impact the manner in which management estimates fair value, but it required additional disclosures, which are included in Note 5.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, or SFAS 159. SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected will be recognized in earnings at each subsequent reporting date. SFAS 159 became effective for the Company January 1, 2008. The Company did not elect the fair value option for any existing eligible financial instruments.

In February 2008, the FASB issued FASB Staff Position No. FAS 140-3 Accounting for Transfers of Financial Assets and Repurchase Financing Transactions, or FSP FAS 140-3. FSP FAS 140-3 addresses whether transactions where assets purchased from a particular counterparty and financed through a repurchase agreement with the same counterparty can be considered and accounted for as separate transactions, or are required to be considered "linked" transactions and may be considered derivatives under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, or SFAS 133. FSP FAS 140-3 requires purchases and subsequent financing through repurchase agreements be considered linked transactions unless all of the following conditions apply: (1) the initial purchase and the use of repurchase agreements to finance the purchase are not contractually contingent upon each other; (2) the repurchase financing entered into between the parties provides full recourse to the transferee and the repurchase price is fixed; (3) the financial assets is readily obtainable in the market; and (4) the financial instrument and the repurchase agreement are not coterminous. This FSP is effective for the Company on January 1, 2009. The Company is currently evaluating FSP FAS 140-3 but does not expect its application to have a significant impact on its financial reporting.

In March 2008, the FASB issued SFAS No. 161, or SFAS 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133. SFAS 161 attempts to improve the transparency of financial reporting by providing additional information about how derivative and hedging activities affect an entity's financial position, financial performance and cash flows. This statement changes the disclosure requirements for derivative instruments and hedging activities by requiring enhanced disclosure about (1) how and why an entity uses derivative instruments, (2) how derivative instruments and related hedged items are accounted for under SFAS Statement 133 and its related interpretations, and (3) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. To meet these objectives, SFAS 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts and of gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative agreements. This disclosure framework is intended to better convey the purpose of derivative use in terms of the risks that an entity is intending to manage. SFAS 161 is effective for the Company on January 1, 2009. The Company expects that adoption of SFAS 161 will increase footnote disclosure to comply with the disclosure requirements for financial statements issued after January 1, 2009.

2. Mortgage-Backed Securities

The following table represents the Company's available for sale RMBS portfolio as of June 30, 2008 and December 31, 2007, at fair value.

| | June 30, 2008 | December 31, 2007 |
|---|------------------|----------------------|
| ----- (dollars in thousands) | | |
| Mortgage-Backed securities, at amortized cost | \$ 1,221,567 | \$ 1,114,137 |
| Gross unrealized gain | - | 10,675 |
| Gross unrealized loss | (104,981) | (522) |
| | ----- | |
| Fair value | \$ 1,116,586 | \$ 1,124,290 |
| | ===== | |

The following table presents the gross unrealized losses, and estimated fair value of the Company's Mortgage-Backed Securities by length of time that such securities have been in a continuous unrealized loss position at June 30, 2008 and December 31, 2007.

| | Unrealized Loss Position For: | | | | | |
|---------------------------------|----------------------------------|----------------------|-------------------------|----------------------|-------------------------|----------------------|
| | Less than 12 Months | | 12 Months or More | | Total | |
| | Estimated Fair Value | Unrealized Losses | Estimated Fair Value | Unrealized Losses | Estimated Fair Value | Unrealized Losses |
| ----- (dollars in thousands) | | | | | | |
| June 30, 2008 | \$1,116,586 | (\$104,981) | - | - | \$1,116,586 | (\$104,981) |
| December 31, 2007 | \$1,124,290 | (\$522) | - | - | \$1,124,290 | (\$522) |

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

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

10

Actual maturities of mortgage-backed securities are generally shorter than stated contractual maturities. Actual maturities of the Company's RMBS are affected by the contractual lives of the underlying mortgages, periodic payments of principal and prepayments of principal.

The following table summarizes the Company's RMBS at June 30, 2008 and December 31, 2007 according to their estimated weighted-average life classifications:

| Weighted Average Life | June 30, 2008 (dollars in thousands) | | | Weighted Average Coupon |
|---|---|----------------|---|----------------------------|
| | Fair Value | Amortized Cost | | |
| Less than one year | | - | - | - |
| Greater than one year and less than five years | \$ 1,071,852 | \$ 1,171,742 | | 6.30% |
| Greater than five years | 44,734 | 49,825 | | 5.72% |
| Total | \$ 1,116,586 | \$ 1,221,567 | | 6.27% |

| Weighted Average Life | December 31, 2007 (dollars in thousands) | | | Weighted Average Coupon |
|---|---|----------------|--|----------------------------|
| | Fair Value | Amortized Cost | | |
| Less than one year | \$ 45,868 | \$ 46,102 | | 6.31% |
| Greater than one year and less than five years | 1,078,422 | 1,068,035 | | 6.32% |
| Greater than five years | - | - | | - |
| Total | \$ 1,124,290 | \$ 1,114,137 | | 6.32% |

The weighted-average lives of the mortgage-backed securities in the tables above are based on data provided through dealer quotes, assuming constant prepayment rates to the balloon or reset date for each security. The prepayment model

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

considers current yield, forward yield, steepness of the curve, current mortgage rates, mortgage rates of the outstanding loan, loan age, margin and volatility.

During the quarter ended June 30, 2008 and the period ended December 31, 2007 the Company did not sell any RMBS.

3. Loans Held for Investment

The following table represents the Company's residential mortgage loans classified as held for investment at June 30, 2008 and December 31, 2007. At June 30, 2008 approximately 4.6% of the Company's investments are adjustable rate mortgage loans and 3.0% are fixed rate mortgage loans. All of the adjustable rate loans held for investment are hybrid ARMs. Hybrid ARMs are mortgages that have interest rates that are fixed for an initial period (typically three, five, seven or 10 years) and thereafter reset at regular intervals subject to interest rate caps. The loans held for investment are carried at their principal balance outstanding less an allowance for loan losses:

| | June 30, 2008 | December 31, 2007 |
|--------------------------------------|------------------------|-------------------|
| ----- | | |
| | (dollars in thousands) | |
| Mortgage loans, at principal balance | \$ 150,629 | \$ 162,452 |
| Less: allowance for loan losses | (546) | (81) |
| | ----- | |
| Mortgage loans held for investment | \$ 150,083 | \$ 162,371 |
| | ===== | |

The following table summarizes the changes in the allowance for loan losses for the mortgage loan portfolio during the six months ended June 30, 2008:

11

| | June 30, 2008 |
|------------------------------|------------------------|
| ----- | |
| | (dollars in thousands) |
| Balance, beginning of period | \$ 81 |
| Provision for loan losses | 465 |
| Charge-offs | - |
| | ----- |
| Balance, end of period | \$ 546 |
| | ===== |

On a quarterly basis, the Company evaluates the adequacy of its allowance for loan losses. As of June 30, 2008, the Company recorded an allowance for loan losses of \$546 thousand representing 36 basis points of the Company's mortgage loan portfolio. As of December 31, 2007, the Company recorded an allowance for loan losses of \$81 thousand representing 5 basis points of the Company's mortgage loan portfolio. At June 30, 2008, there were no loans 60 days or more past due and all loans were accruing interest.

The geographic distribution of the Company's loans held for investment at June 30, 2008 was as follows:

(dollars in thousands)

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

| State | Number of Loans | Unpaid Principal Balance |
|---|-----------------|--------------------------|
| CA | 50 | \$ 35,854 |
| IL | 23 | 14,947 |
| NJ | 18 | 11,642 |
| SC | 8 | 6,968 |
| NY | 10 | 6,741 |
| MA | 7 | 5,503 |
| AZ | 8 | 5,320 |
| MN | 8 | 5,250 |
| WA | 7 | 4,903 |
| FL | 7 | 4,770 |
| NH | 7 | 4,654 |
| NV | 4 | 4,327 |
| CO | 5 | 3,951 |
| GA | 6 | 3,914 |
| VA | 5 | 3,843 |
| NC | 5 | 3,440 |
| MD | 5 | 3,384 |
| MO | 5 | 3,380 |
| TX | 5 | 2,938 |
| PA | 4 | 2,695 |
| CT | 4 | 2,550 |
| UT | 3 | 2,374 |
| Other states, individually less than 1% of aggregate current balance | 12 | 8,981 |
| Unamortized premium/discount | | (1,700) |
| Allowance for loan losses | | (546) |
| Total | | \$ 150,083 |

The Company did not sell any mortgage loans during the quarter or six months ended June 30, 2008.

4. Securitized Loans Held for Investment

12

The following table represents the Company's securitized residential mortgage loans classified as held for investment at June 30, 2008. The Company did not hold any securitized loans at December 31, 2007. At June 30, 2008 approximately 16.8% of the Company's securitized loans are adjustable rate mortgage loans and 13.7% are fixed rate mortgage loans. All of the adjustable rate loans held for investment are hybrid ARMs. Hybrid ARMs are mortgages that have interest rates that are fixed for an initial period (typically three, five, seven or 10 years) and thereafter reset at regular intervals subject to interest rate caps. The loans held for investment are carried at their principal balance outstanding less an allowance for loan losses:

| | June 30, 2008 |
|---|------------------------|
| | (dollars in thousands) |
| Securitized mortgage loans, at principal balance | \$ 614,278 |

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

| | |
|--|------------|
| Less: allowance for loan losses | (698) |
| | ----- |
| Securitized mortgage loans held for investment | \$ 613,580 |
| | ===== |

The following table summarizes the changes in the allowance for loan losses for the mortgage loan portfolio during the six months ended June 30, 2008:

| | |
|------------------------------|--------|
| June 30, 2008 | |
| ----- | |
| (dollars in thousands) | |
| Balance, beginning of period | \$ - |
| Provision for loan losses | 698 |
| Charge-offs | - |
| | ----- |
| Balance, end of period | \$ 698 |
| | ===== |

On a quarterly basis, the Company evaluates the adequacy of its allowance for loan losses. At quarter end, the Company recorded an allowance for loan losses of \$698 thousand for the quarter ended June 30, 2008, representing 12 basis points of the principal balance of the Company's securitized mortgage loan portfolio. At June 30, 2008, there were no loans 60 days or more past due and all loans were accruing interest.

During the quarter ended June 30, 2008, the Company transferred \$619.7 million of its residential mortgage loans held for investment to the PHHMC 2008-CIM1 Trust in a securitization transaction. In this transaction, the Company sold \$536.9 million of AAA-rated fixed and floating rate bonds to third party investors and retained \$46.3 million of AAA-rated mezzanine bonds and \$36.5 million in subordinated bonds which provide credit support to the certificates issued to third parties. The certificates issued by the trust are collateralized by loans held for investment that have been transferred to the PHHMC 2008-CIM1 Trust. The Company incurred approximately \$1.3 million in issuance costs that were deducted from the proceeds of the transaction and are being amortized over the life of the bonds. This transaction was accounted for as a financing pursuant to SFAS 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.

5. Fair Value Measurements

SFAS 157, defines fair value, establishes a framework for measuring fair value, establishes a three-level valuation hierarchy for disclosure of fair value measurement and enhances disclosure requirements for fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follow:

Level 1- inputs to the valuation methodology are quoted prices (unadjusted) for identical assets and liabilities in active markets.

Level 2 - inputs to the valuation methodology include quoted prices for

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3 - inputs to the valuation methodology are unobservable and significant to fair value.

Mortgage-Backed Securities and interest rate swaps are valued using a pricing model. The MBS pricing model incorporates such factors as coupons, prepayment speeds, spread to the Treasury and swap curves, convexity, duration, periodic and life caps, and credit enhancement. Interest rate swaps are modeled by incorporating such factors as the Treasury curve, LIBOR rates, and the receive rate on the interest rate swaps. Management reviews the fair values determined by the pricing model and compares its results to dealer quotes received on each investment to validate reasonableness of the valuations indicated by the pricing model. The dealer quotes will incorporate common market pricing methods, including a spread measurement to the Treasury curve or interest rate swap curve as well as underlying characteristics of the particular security including coupon, periodic and life caps, rate reset period, issuer, additional credit support and expected life of the security. The Company's financial assets and liabilities carried at fair value on a recurring basis are valued at June 30, 2008 as follows:

| | Level 1 | Level 2 | Level 3 |
|----------------------------|------------------------|---------|--------------|
| | (dollars in thousands) | | |
| ----- | | | |
| Assets: | | | |
| Mortgage-Backed Securities | \$ | - \$ | 1,116,586 \$ |
| | | | - |
| Liabilities: | | | |
| Interest Rate Swaps | \$ | - \$ | 10,065 \$ |
| | | | - |

6. Repurchase Agreements

(A) Mortgage-Backed Securities

The Company had outstanding \$909.1 million and \$270.6 million of repurchase agreements with weighted average borrowing rates of 4.85% and 5.02% and weighted average remaining maturities of 23 and 22 days as of June 30, 2008 and December 31, 2007 respectively. At June 30, 2008, RMBS pledged as collateral under these repurchase agreements had an estimated fair value of \$961.4 million, carrying value of \$911.7 million, including accrued interest, and cash totaling \$29.5 million. At December 31, 2007, RMBS pledged as collateral had an estimated fair value of \$271.7 million. The interest rates of these repurchase agreements are generally indexed to the one-month LIBOR rate and reprice accordingly.

At June 30, 2008 and December 31, 2007, the repurchase agreements collateralized by RMBS had the following remaining maturities:

| | June 30, 2008 | December 31, 2007 |
|-----------------------------------|------------------------|-------------------|
| | (dollars in thousands) | |
| Within 30 days | \$ 539,603 | \$ 270,584 |
| 30 to 59 days | 344,972 | - |
| 60 to 89 days | - | - |
| 90 to 119 days | 24,514 | - |
| Greater than or equal to 120 days | - | - |
| ----- | | |
| Total | \$ 909,089 | \$ 270,584 |
| ===== | | |

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

At June 30, 2008 and December 31, 2007, the Company did not have an amount at risk greater than 10% of equity with any counterparty.

(B) Loans Held for Investment

14

The Company has entered into two master repurchase agreements pursuant to which it finances mortgage loans. One agreement is a \$500 million lending facility of which \$200 million is on an uncommitted basis. This agreement terminates January 16, 2009. The second agreement is a \$350 million committed lending facility. This agreement terminates January 29, 2010. As of June 30, 2008 and December 31, 2007, the Company did not have any amounts borrowed against these facilities. On July 29, 2008, the Company terminated both lending facilities.

Currently the sub-prime mortgage sector is experiencing unprecedented losses and there is weakness in the broader mortgage market that has increased volatility in market valuation of investments and the availability of credit which may adversely affect one or more of the Company's lenders and could cause one or more of the Company's lenders to be unwilling or unable to provide it with additional financing. This could potentially increase the Company's financing costs and reduce liquidity. If one or more major market participants fail, it could negatively impact the marketability of all fixed income securities and this could negatively impact the value of the securities in the Company's portfolio, thus reducing its net book value. Furthermore, if many of the Company's lenders are unwilling or unable to provide it with additional financing, the Company could be forced to sell its investments at an inopportune time when prices are depressed.

7. Securitized Debt

All of the Company's securitized debt is collateralized by residential mortgage loans. For financial reporting purposes, the Company's securitized debt is accounted for as a financing pursuant to SFAS 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. Thus, the residential mortgage loans held as collateral are recorded in the assets of the Company as securitized loans and the securitized debt is recorded as a liability in the statement of financial condition.

At June 30, 2008, the securitized debt of the Company was collateralized by residential mortgage loans and has a principal balance of \$504.4 million. The debt matures between the years 2023 and 2038. At June 30, 2008 the debt carried a weighted average cost of financing equal to 5.96%. At December 31, 2007 the Company had no securitized debt.

8. Interest Rate Swaps

In connection with the Company's interest rate risk management strategy, the Company economically hedges a portion of its interest rate risk by entering into derivative financial instrument contracts. As of June 30, 2008, such instruments are comprised of interest rate swaps, which in effect modify the cash flows on repurchase agreements. The Company's swaps are used to lock-in a fixed rate relative to a portion of its current and anticipated future 30-day term repurchase agreements. The Company accounts for interest rate swaps as freestanding derivatives with changes in fair value recorded in earnings.

The table below represents the Company's swaps outstanding:

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

| | Notional Amount | Weighted Average Pay Rate | Weighted Average Receive Rate | Net Estimated Fair Value/Carrying Value |
|-------------------|-----------------|------------------------------|----------------------------------|---|
| | | (dollars in thousands) | | |
| June 30, 2008 | \$ 1,008,914 | 4.10% | 2.48% | (\$10,065) |
| December 31, 2007 | \$ 1,235,000 | 4.04% | 4.94% | (\$4,156) |
| 9. Common Stock | | | | |

During the quarter ended June 30, 2008, the Company declared dividends to common shareholders totaling \$6.0 million or \$0.16 per share, which were paid on July 31, 2008.

10. Long Term Incentive Plan

15

The Company has adopted a long term stock incentive plan to provide incentives to its independent directors, employees of FIDAC and its affiliates, to stimulate their efforts towards the Company's continued success, long-term growth and profitability and to attract, reward and retain personnel and other service providers. The Incentive Plan authorizes the Compensation Committee of the board of directors to grant awards, including incentive stock options, non-qualified stock options, restricted shares and other types of incentive awards. The Incentive Plan authorizes the granting of options or other awards for an aggregate of the greater of 8.0% of the outstanding shares of its common stock, or 3,119,988 shares, up to a ceiling of 40,000,000 shares.

As of June 30, 2008, the Company has granted restricted stock awards in the amount of 1,301,000 shares to FIDAC's employees and the Company's independent directors. Of these shares, 32,300 shares vested and 4,768 shares were forfeited or cancelled during the quarter ended June 30, 2008. The awards to the independent directors vested on the date of grant, and the awards to FIDAC's employees vest quarterly over a period of 10 years.

At June 30, 2008 there are approximately 1.2 million unvested shares of restricted stock issued to employees of FIDAC. For the three months ended June 30, 2008, compensation expense less general and administrative costs associated with the amortization of the fair value of the restricted stock totaled \$337 thousand.

11. Income Taxes

As a REIT, the Company is not subject to Federal income tax on earnings distributed to its shareholders. Most states recognize REIT status as well. The Company has decided to distribute the majority of its income. During the quarter ended June 30, 2008, the Company recorded no income tax expense related to state and federal tax liabilities on undistributed income for an effective tax rate of 0%.

12. Credit Risk and Interest Rate Risk

The Company's primary components of market risk are credit risk and interest rate risk. The Company is subject to credit risk in connection with its

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

investments in residential mortgage loans and credit sensitive mortgage-backed securities. When the Company assumes credit risk, it attempts to minimize interest rate risk through asset selection, hedging and matching the income earned on mortgage assets with the cost of related liabilities. The Company is subject to interest rate risk, primarily in connection with its investments in fixed-rate and adjustable-rate mortgage backed securities, residential mortgage loans and repurchase agreements. When the Company assumes interest rate risk, it minimizes credit risk through asset selection. The Company's strategy is to purchase loans underwritten to agreed-upon specifications of selected originators in an effort to mitigate credit risk. The Company has established a whole loan target market including prime borrowers with FICO scores generally greater than 650, Alt-A documentation, geographic diversification, owner-occupied property, moderate loan size and moderate loan to value ratio. These factors are considered to be important indicators of credit risk.

13. Management Agreement and Related Party Transactions

The Company has entered into a management agreement with FIDAC, which provides for an initial term through December 31, 2010 with automatic one-year extension options and subject to certain termination rights. The Company pays FIDAC a quarterly management fee equal to 1.75% per annum of the gross Stockholders' Equity (as defined in the management agreement) of the Company. FIDAC is also entitled to a quarterly incentive fee equal to 20% of the dollar amount by which Core Earnings (as defined in the management agreement) on a rolling four-quarter basis and before the incentive management fee, exceeds the product of (1) the weighted average of the issue price per share of all of our public offerings multiplied by the weighted average number of shares of common stock outstanding in such quarter and (2) 0.50% plus one-fourth of the average of the one month LIBOR rate for such quarter and the previous three quarters. For the initial four quarters following the Company's initial public offering, Core Earnings and the LIBOR rate will be calculated on the basis of each of the previously completed quarters on an annualized basis. Core Earnings and LIBOR rate for the initial quarter will each be calculated from the settlement date of the offering on an annualized basis. At June 30, 2008 quarterly management fees in the amount of \$2.2 million were accrued and payable to FIDAC. At December 31, 2007 quarterly management fees in the amount of \$1.2 million were accrued and payable to FIDAC.

The Company is obligated to reimburse FIDAC for its costs incurred under the management agreement. In addition, the management agreement permits FIDAC to require the Company to pay for its pro rata portion of rent, telephone, utilities, office furniture, equipment, machinery and other office, internal and overhead expenses of FIDAC incurred in the operation of the Company. These expenses are allocated between FIDAC and the Company based on the ratio of the Company's proportion of gross assets compared to all remaining gross assets managed by FIDAC as calculated at each quarter end. FIDAC and the Company will modify this allocation methodology, subject to the Company's board of directors' approval if the allocation becomes inequitable (i.e., if the Company becomes very highly leveraged compared to FIDAC's other funds and accounts). For the quarter ending June 30, 2008, FIDAC has waived its right to request reimbursement from the Company for these expenses. The Company was required to reimburse FIDAC for all costs FIDAC paid on behalf of the Company incurred in connection with the formation, organization and initial public offering of the Company, which amounted to \$697,947.

During the quarter ended June 30, 2008, 32,300 shares of restricted stock issued by the Company to FIDAC's employees vested, as discussed in Note 10.

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

In March 2008, the Company entered into a RMBS repurchase agreement and a receivables sales agreement with Annaly. These agreements contain customary representations, warranties and covenants. As of June 30, 2008, the Company was financing \$50 million under this agreement. As of August 6, 2008, the Company had \$606 million outstanding under this agreement, which constitutes 48% of its financing.

14. Commitments and Contingencies

From time to time, the Company may become involved in various claims and legal actions arising in the ordinary course of business. Management is not aware of any reported or unreported contingencies at June 30, 2008.

17

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

Special Note Regarding Forward-Looking Statements

We make forward-looking statements in this report that are subject to risks and uncertainties. These forward-looking statements include information about possible or assumed future results of our business, financial condition, liquidity, results of operations, plans and objectives. When we use the words "believe," "expect," "anticipate," "estimate," "plan," "continue," "intend," "should," "may," "would," "will" or similar expressions, we intend to identify forward-looking statements. Statements regarding the following subjects, among others, are forward-looking by their nature:

- o our business and investment strategy;
- o our projected operating results;
- o our ability to obtain future financing arrangements;
- o general volatility of the securities markets in which we invest;
- o our expected investments;
- o interest rate mismatches between our investments and our borrowings used to fund such purchases;
- o changes in interest rates and mortgage prepayment rates;
- o effects of interest rate caps on our investments;
- o rates of default or decreased recovery rates on our investments;
- o prepayments of the mortgage and other loans underlying our mortgage-backed or other asset-backed securities;
- o the degree to which our hedging strategies may or may not protect us from interest rate volatility;
- o changes in governmental regulations, tax law and rates and similar matters;

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

- o availability of investment opportunities in real estate-related and other securities;
- o availability of qualified personnel;
- o estimates relating to our ability to make distributions to our stockholders in the future;
- o our understanding of our competition; and
- o market trends in our industry, interest rates, the debt securities markets or the general economy.

The forward-looking statements are based on our beliefs, assumptions and expectations of our future performance, taking into account all information currently available to us. You should not place undue reliance on these forward-looking statements. These beliefs, assumptions and expectations can change as a result of many possible events or factors, not all of which are known to us. Some of these factors are described under the caption "Risk Factors" in our most recent Annual Report on Form 10-K and any subsequent Quarterly Reports on Form 10-Q. If a change occurs, our business, financial condition, liquidity and results of operations may vary materially from those expressed in our forward-looking statements. Any forward-looking statement speaks only as of the date on which it is made. New risks and uncertainties arise from time to time, and it is impossible for us to predict those events or how they may affect us. Except as required by law, we are not obligated to, and do not intend to, update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

18

Executive Summary

We are a specialty finance company that invests in residential mortgage loans, residential mortgage-backed securities, real estate related securities and various other asset classes. We are externally managed by FIDAC. We intend to elect and qualify to be taxed as a REIT for federal income tax purposes commencing with our taxable year ending on December 31, 2007. Our targeted asset classes and the principal investments we expect to make in each are as follows:

- o Whole mortgage loans, consisting of:
 - o Prime mortgage loans
 - o Jumbo prime mortgage loans
 - o Alt-A mortgage loans
- o RMBS, consisting of:
 - o Non-Agency RMBS, including investment-grade and non-investment grade classes, including the BB-rated, B-rated and non-rated classes
 - o Agency RMBS
- o Asset Backed Securities, or ABS, consisting of:
 - o Debt and equity tranches of CDOs

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

- o CMBS
- o Consumer and non-consumer ABS, including investment-grade and non-investment grade classes, including the BB-rated, B-rated and non-rated classes

We completed our initial public offering on November 21, 2007. In that offering and in a concurrent private offering we raised net proceeds before offering expenses of approximately \$533.6 million. We have commenced investing these proceeds, and as of June 30, 2008, had a portfolio of RMBS and whole mortgage loans of approximately \$1.9 billion.

Our objective is to provide attractive risk-adjusted returns to our investors over the long-term, primarily through dividends and secondarily through capital appreciation. We intend to achieve this objective by investing in a broad class of financial assets to construct an investment portfolio that is designed to achieve attractive risk-adjusted returns and that is structured to comply with the various federal income tax requirements for REIT status. We expect that over the near term our investment portfolio will continue to be weighted toward non-Agency RMBS, subject to maintaining our REIT qualification and our 1940 Act exemption, which may, depending on the composition of our investment portfolio, require us to purchase Agency RMBS or other qualifying assets. Over time we expect that our investment portfolio will become more weighted toward residential mortgage loans.

Our investment strategy is intended to take advantage of opportunities in the current interest rate and credit environment. We will adjust our strategy to changing market conditions by shifting our asset allocations across these various asset classes as interest rate and credit cycles change over time. We believe that our strategy, combined with FIDAC's experience, will enable us to pay dividends and achieve capital appreciation throughout changing market cycles. We expect to take a long-term view of assets and liabilities, and our reported earnings and mark-to-market valuations at the end of a financial reporting period will not significantly impact our objective of providing attractive risk-adjusted returns to our stockholders over the long-term.

We use leverage to seek to increase our potential returns and to fund the acquisition of our assets. Our income is generated primarily by the difference, or net spread, between the income we earn on our assets and the cost of our borrowings. We expect to finance our investments using a variety of financing sources including repurchase agreements, warehouse facilities, securitizations, commercial paper and term financing CDOs. We expect to manage our debt by utilizing interest rate hedges, such as interest rate swaps, to reduce the effect of interest rate fluctuations related to our debt.

19

Recent Developments

We commenced operations in November 2007 in the midst of challenging market conditions which affected the cost and availability of financing from the facilities with which we expected to finance our investments. These instruments included repurchase agreements, warehouse facilities, securitizations, asset-backed commercial paper (ABCP) and term CDOs. The liquidity crisis which commenced in August 2007 affected each of these sources--and their individual providers--to different degrees; some sources generally became unavailable, some available but at a high cost, and some were largely unaffected. For example, in the repurchase agreement market, non-Agency RMBS became harder to finance,

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

depending on the type of assets collateralizing the RMBS. The amount, term and margin requirements associated with these types of financings were also impacted. At that time, warehouse facilities to finance whole loan prime residential mortgages were generally available from major banks, but at significantly higher cost and had greater margin requirements than previously offered. It was also extremely difficult to term finance whole loans through securitization or bonds issued by a CDO structure. Financing using ABCP froze as issuers became unable to place (or roll) their securities, which resulted, in some instances, in forced sales of mortgage-backed securities, or MBS, and other securities which further negatively impacted the market value of these assets.

Although the credit markets had been undergoing much turbulence, as we started ramping up our portfolio, we noted a slight easing. We entered into a number of repurchase agreements we could use to finance RMBS. In January 2008, we entered into two whole mortgage loan repurchase agreements. As we began to see the availability of financing, we were also seeing better underwriting standards used to originate new mortgages. We commenced buying and financing RMBS and also entered into agreements to purchase whole mortgage loans. We purchased high credit quality assets which we believed we would be readily able to finance.

Beginning mid-February 2008, credit markets experienced a dramatic and sudden adverse change. The severity of the limitation on liquidity was largely unanticipated by the markets. Credit once again froze, and in the mortgage market, valuations of non-Agency RMBS and whole mortgage loans came under severe pressure. This credit crisis began in early February 2008, when a heavily leveraged investor announced that it had to de-lever and liquidate a portfolio of approximately \$30 billion of non-Agency RMBS. Prices of these types of securities dropped dramatically, and lenders started lowering the prices on non-Agency RMBS that they held as collateral to secure the loans they had extended. The subsequent failure of a major investment bank worsened the crisis. During the past six months, due to the deterioration in the market value of our assets, we received margin calls under our repurchase agreements, amended liquidity and net income covenants in our warehouse facilities, obtained additional funding from third parties, including from Annaly, and took other steps to increase our liquidity.

The challenges of the first quarter have continued into and subsequent to the second quarter, as financing difficulties have severely pressured liquidity and asset values. Securities trading remains limited and mortgage securities financing markets remain challenging as the industry continues to report negative news. This dislocation in the non-Agency mortgage sector has made it difficult for us to obtain short-term financing on favorable terms. As a result, we have completed loan securitizations in order to obtain long-term financing and terminated our un-utilized whole loan repurchase agreements in order to avoid paying non-usage fees under those agreements. In addition, we have continued to seek funding from Annaly. Under these circumstances, we expect to take actions intended to protect our liquidity, which may include reducing borrowings and disposing of assets.

During this period of market dislocation, fiscal and monetary policymakers have established new liquidity facilities for primary dealers and commercial banks, reduced short-term interest rates, and passed legislation that will address the challenges of mortgage borrowers and lenders. This legislation, the Housing and Economic Recovery Act of 2008, seeks to forestall home foreclosures for distressed borrowers and assist communities with foreclosure problems, as well as create a stronger regulator for, and provide economic support to, Fannie Mae and Freddie Mac, institutions that are critical to the liquidity and stability of the mortgage market. Although these aggressive steps are intended to protect and support the US housing and mortgage market, we continue to operate under very difficult market conditions.

Trends

We expect the results of our operations to be affected by various factors, many of which are beyond our control. Our results of operations will primarily depend on, among other things, the level of our net interest income, the market value of our assets, and the supply of and demand for such assets. Our net interest income, which reflects the amortization of purchase premiums and accretion of discounts, varies primarily as a result of changes in interest rates, borrowing costs, and prepayment speeds, which is a measurement of how quickly borrowers pay down the unpaid principal balance on their mortgage loans.

Prepayment Speeds. Prepayment speeds, as reflected by the Constant Prepayment Rate, or CPR, vary according to interest rates, the type of investment, conditions in financial markets, competition and other factors, none of which can be predicted with any certainty. In general, when interest rates rise, it is relatively less attractive for borrowers to refinance their mortgage loans, and as a result, prepayment speeds tend to decrease. When interest rates fall, prepayment speeds tend to increase. For mortgage loan and RMBS investments purchased at a premium, as prepayment speeds increase, the amount of income we earn decreases because the purchase premium we paid for the bonds amortizes faster than expected. Conversely, decreases in prepayment speeds result in increased income and can extend the period over which we amortize the purchase premium. For mortgage loan and RMBS investments purchased at a discount, as prepayment speeds increase, the amount of income we earn increases because of the acceleration of the accretion of the discount into interest income. Conversely, decreases in prepayment speeds result in decreased income and can extend the period over which we accrete the purchase discount into interest income.

Rising Interest Rate Environment. As indicated above, as interest rates rise, prepayment speeds generally decrease, increasing our interest income. Rising interest rates, however, increase our financing costs which may result in a net negative impact on our net interest income. In addition, if we acquire Agency and non-Agency RMBS collateralized by monthly reset adjustable-rate mortgages, or ARMs, and three- and five-year hybrid ARMs, such interest rate increases could result in decreases in our net investment income, as there could be a timing mismatch between the interest rate reset dates on our RMBS portfolio and the financing costs of these investments. Monthly reset ARMs are ARMs on which coupon rates reset monthly based on indices such as the one-month London Interbank Offering Rate, or LIBOR. Hybrid ARMs are mortgages that have interest rates that are fixed for an initial period (typically three, five, seven or 10 years) and thereafter reset at regular intervals subject to interest rate caps.

With respect to our floating rate investments, such interest rate increases should result in increases in our net investment income because our floating rate assets are greater in amount than the related floating rate liabilities. Similarly, such an increase in interest rates should generally result in an increase in our net investment income on fixed-rate investments made by us because our fixed-rate assets would be greater in amount than our fixed-rate liabilities. We expect, however, that our fixed-rate assets would decline in value in a rising interest rate environment and that our net interest spreads on fixed rate assets could decline in a rising interest rate environment to the extent such assets are financed with floating rate debt.

Credit Risk. One of our strategic focuses is acquiring assets which we believe to be of high credit quality. We believe this strategy will generally keep our credit losses and financing costs low. We retain the risk of potential

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

credit losses on all of the residential mortgage loans we hold in our portfolio. Additionally, some of our investments in RMBS may be qualifying interests for purposes of maintaining our exemption from the 1940 Act because we retain a 100% ownership interest in the underlying loans. If we purchase all classes of these securitizations, we have the credit exposure on the underlying loans. Prior to the purchase of these securities, we conduct a due diligence process that allows us to remove loans that do not meet our credit standards based on loan-to-value ratios, borrowers' credit scores, income and asset documentation and other criteria that we believe to be important indications of credit risk.

Size of Investment Portfolio. The size of our investment portfolio, as measured by the aggregate unpaid principal balance of our mortgage loans and aggregate principal balance of our mortgage related securities and the other assets we own is also a key revenue driver. Generally, as the size of our investment portfolio grows, the amount of interest income we receive increases. The larger investment portfolio, however, drives increased expenses as we incur additional interest expense to finance the purchase of our assets.

21

Since changes in interest rates may significantly affect our activities, our operating results depend, in large part, upon our ability to effectively manage interest rate risks and prepayment risks while maintaining our status as a REIT.

Current Environment. While the current situation in the sub-prime mortgage sector may provide us opportunities, the current weakness in the broader mortgage market could adversely affect one or more of our potential lenders and could cause one or more of our potential lenders to be unwilling or unable to provide us with financing or require us to post additional collateral. In general, this could potentially increase our financing costs and reduce our liquidity or require us to sell assets at an inopportune time. We expect to use a number of sources to finance our investments, including repurchase agreements, warehouse facilities, securitizations, asset-backed commercial paper and term CDOs. Current market conditions have affected the cost and availability of financing from each of these sources and their individual providers to different degrees; some sources generally are unavailable, some are available but at a high cost, and some are largely unaffected. For example, in the repurchase agreement market, borrowers have been affected differently depending on the type of security they are financing. Non-Agency RMBS have been harder to finance, depending on the type of assets collateralizing the RMBS. The amount, term and margin requirements associated with these types of financings have been negatively impacted.

Currently, warehouse facilities to finance whole loan prime residential mortgages are generally available from major banks, but at significantly higher cost and have greater margin requirements than previously offered. Many major banks that offer warehouse facilities have also reduced the amount of capital available to new entrants and consequently the size of those facilities offered now are smaller than those previously available. We decided to terminate our two whole loan repurchase agreements in order to avoid paying non-usage fees under those agreements.

It is currently a challenging market to term finance whole loans through securitization or bonds issued by a CDO structure. The highly rated senior bonds in these securitizations and CDO structures currently have liquidity, but at much wider spreads than issues priced in recent history. The junior subordinate tranches of these structures currently have few buyers and current market conditions have forced issuers to retain these lower rated bonds rather than

sell them.

Certain issuers of asset-backed commercial paper, or ABCP, have been unable to place (or roll) their securities, which has resulted, in some instances, in forced sales of MBS and other securities which has further negatively impacted the market value of these assets. These market conditions are fluid and likely to change over time. As a result, the execution of our investment strategy may be dictated by the cost and availability of financing from these different sources.

If one or more major market participants fails or otherwise experiences a major liquidity crisis, as was the case for Bear Stearns & Co. in March 2008, it could negatively impact the marketability of all fixed income securities and this could negatively impact the value of the securities we acquire, thus reducing our net book value. Furthermore, if many of our potential lenders are unwilling or unable to provide us with financing, we could be forced to sell our securities or residential mortgage loans at an inopportune time when prices are depressed. For example, for the quarter ended March 31, 2008, we sold assets with a carrying value of \$369.9 million for an aggregate loss of \$31.2 million. We did not sell any assets during the quarter ended June 30, 2008.

In the current market, it may be difficult or impossible to obtain third party pricing on the investments we purchase. In addition, validating third party pricing for our investments may be more subjective as fewer participants may be willing to provide this service to us. Moreover, the current market is more illiquid than in recent history for some of the investments we purchase. Illiquid investments typically experience greater price volatility as a ready market does not exist. As volatility increases or liquidity decreases we may have greater difficulty financing our investments which may negatively impact our earnings and the execution of our investment strategy.

Critical Accounting Policies

Our financial statements are prepared in accordance with accounting principles generally accepted in the United States of America. These accounting principles may require us to make some complex and subjective decisions and assessments. Our most critical accounting policies will involve decisions and assessments that could affect our reported assets and liabilities, as well as our reported revenues and expenses. We believe that all of the decisions and assessments upon which our financial statements are based will be reasonable at the time made and based upon information available to us at that time. At each quarter end, we calculate estimated fair value using a pricing model. We validate our pricing model by obtaining independent pricing on all of our assets and performing a verification of those sources to our own internal estimate of fair value. We have identified what we believe will be our most critical accounting policies to be the following:

22

Valuation of Investments

On January 1, 2008, we adopted SFAS 157, which defines fair value, establishes a framework for measuring fair value in accordance with GAAP and expands disclosures about fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follow:

Level 1- inputs to the valuation methodology are quoted prices (unadjusted) for identical assets and liabilities in active markets.

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

Level 2 - inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3 - inputs to the valuation methodology are unobservable and significant to fair value.

Mortgage-Backed Securities and interest rate swaps are valued using a pricing model. The MBS pricing model incorporates such factors as coupons, prepayment speeds, spread to the Treasury and swap curves, convexity, duration, periodic and life caps, and credit enhancement. Interest rate swaps are modeled by incorporating such factors as the Treasury curve, LIBOR rates, and the receive rate on the interest rate swaps. Management reviews the fair values determined by the pricing model and compares its results to dealer quotes received on each investment to validate the reasonableness of the valuations indicated by the pricing models. The dealer quotes will incorporate common market pricing methods, including a spread measurement to the Treasury curve or interest rate swap curve as well as underlying characteristics of the particular security including coupon, periodic and life caps, rate reset period, issuer, additional credit support and expected life of the security.

Any changes to the valuation methodology are reviewed by management to ensure the changes are appropriate. As markets and products develop and the pricing for certain products becomes more transparent, we continue to refine our valuation methodologies. The methods used by us may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while we believe our valuation methods are appropriate and consistent with other market participants, the use of different methodologies, or assumptions, to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. We use inputs that are current as of the measurement date, which may include periods of market dislocation, during which price transparency may be reduced. This condition could cause our financial instruments to be reclassified from Level 2 to Level 3 in the future.

We define the fair value of our RMBS using "Level 2" methodology as described above.

Loans Held for Investment

We purchase residential mortgage loans and classify them as loans held for investment on the statement of financial condition. Loans held for investment are intended to be held to maturity and, accordingly, are reported at the principal amount outstanding, net of provisions for loan losses.

Loan loss provisions are examined quarterly and updated to reflect expectations of future probable credit losses based on factors such as originator historical losses, geographic concentration, individual loan characteristics, experienced losses, and expectations of future loan pool behavior. As credit losses occur, the provision for loan losses will reflect that realization.

When we determine that it is probable that contractually due specific amounts are deemed uncollectable, the loan is considered impaired. To measure our impairment we determine the excess of the recorded investment amount over the net fair value of the collateral, as reduced by selling costs. Any deficiency between the carrying amount of an asset and the net sales price of repossessed collateral is charged to the allowance for loan losses.

An allowance for mortgage loans is maintained at a level believed adequate by management to absorb probable losses. We may elect to sell a loan held for investment due to adverse changes in credit fundamentals. Once the determination has been made by us that we will no longer hold the loan for investment, we will account for the loan at the lower of amortized cost or estimated fair value. The reclassification of the loan and recognition of impairments could adversely affect our reported earnings.

Valuations of Available-for-Sale Securities

We expect our investments in RMBS will be primarily classified as available-for-sale securities that are carried on the statement of financial condition at their fair value. This classification will result in changes in fair values being recorded as statement of financial condition adjustments to accumulated other comprehensive income or loss, which is a component of stockholders' equity.

Our available-for-sale securities have fair values as determined with reference to fair values calculated using a pricing model. Management reviews the fair values generated to insure prices are reflective of the current market. We perform a validation of the fair value calculated by the pricing model by comparing its results to independent prices provided by dealers in the securities and/or third party pricing services. If dealers or independent pricing services are unable to provide a price for an asset, or if the price provided by them is deemed unreliable by FIDAC, then the asset will be valued at its fair value as determined in good faith by FIDAC. The pricing is subject to various assumptions which could result in different presentations of value.

When the fair value of an available-for-sale security is less than its amortized cost for an extended period, we consider whether there is an other-than-temporary impairment in the value of the security. If, based on our analysis, an other-than-temporary impairment exists, the cost basis of the security is written down to the then-current fair value, and the unrealized loss is transferred from accumulated other comprehensive loss as an immediate reduction of current earnings (as if the loss had been realized in the period of other-than-temporary impairment). The determination of other-than-temporary impairment is a subjective process, and different judgments and assumptions could affect the timing of loss realization.

We consider the following factors when determining an other-than-temporary impairment for a security:

- o The length of time and the extent to which the market value has been less than the amortized cost;
- o Whether the security has been downgraded by a rating agency; and
- o Our intent to hold the security for a period of time sufficient to allow for any anticipated recovery in market value.

The determination of other-than-temporary impairment is made at least quarterly. If we determine an impairment to be other than temporary we will realize a loss which will negatively impact current income.

Investment Consolidation

For each investment we make, we will evaluate the underlying entity that issued the securities we will acquire or to which we will make a loan to

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

determine the appropriate accounting. In performing our analysis, we refer to guidance in Statement of Financial Accounting Standards (SFAS) No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, and FASB Interpretation No. (FIN) 46R, Consolidation of Variable Interest Entities. FIN 46R addresses the application of Accounting Research Bulletin No. 51, Consolidated Financial Statements, to certain entities in which voting rights are not effective in identifying an investor with a controlling financial interest. In variable interest entities, or VIEs, an entity is subject to consolidation under FIN 46R if the investors either do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support, are unable to direct the entity's activities, or are not exposed to the entity's losses or entitled to its residual returns. VIEs within the scope of FIN 46R are required to be consolidated by their primary beneficiary. The primary beneficiary of a VIE is determined to be the party that absorbs a majority of the entity's expected losses, its expected returns, or both. This determination can sometimes involve complex and subjective analyses.

24

Interest Income Recognition

Interest income on available-for-sale securities and loans held for investment is recognized over the life of the investment using the effective interest method as described by SFAS No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases, for securities of high credit quality and Emerging Issues Task Force No. 99-20, Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets, for all other securities. Income recognition is suspended for loans when, in the opinion of management, a full recovery of income and principal becomes doubtful. Income recognition is resumed when the loan becomes contractually current and performance is demonstrated to be resumed.

Under SFAS No. 91 and Emerging Issues Task Force No. 99-20, management will estimate, at the time of purchase, the future expected cash flows and determine the effective interest rate based on these estimated cash flows and our purchase price. As needed, these estimated cash flows will be updated and a revised yield computed based on the current amortized cost of the investment. In estimating these cash flows, there will be a number of assumptions that will be subject to uncertainties and contingencies. These include the rate and timing of principal payments (including prepayments, repurchases, defaults and liquidations), the pass-through or coupon rate and interest rate fluctuations. In addition, interest payment shortfalls due to delinquencies on the underlying mortgage loans, and the timing of the magnitude of credit losses on the mortgage loans underlying the securities have to be judgmentally estimated. These uncertainties and contingencies are difficult to predict and are subject to future events that may impact management's estimates and our interest income.

Accounting For Derivative Financial Instruments

Our policies permit us to enter into derivative contracts, including interest rate swaps and interest rate caps, as a means of mitigating our interest rate risk. We intend to use interest rate derivative instruments to mitigate interest rate risk rather than to enhance returns.

We account for derivative financial instruments in accordance with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended and interpreted. SFAS No. 133 requires an entity to recognize all derivatives as either assets or liabilities in the statement of financial condition and to

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

measure those instruments at fair value. Additionally, the fair value adjustments will affect either other comprehensive income in stockholders' equity until the hedged item is recognized in earnings or net income depending on whether the derivative instrument qualifies as a hedge for accounting purposes and, if so, the nature of the hedging activity. We have elected not to qualify for hedge accounting treatment. As a result, our operating results may suffer because losses on the derivatives that we enter into may not be offset by a change in the fair value of the related hedged transaction.

In the normal course of business, we may use a variety of derivative financial instruments to manage, or hedge, interest rate risk. These derivative financial instruments must be effective in reducing our interest rate risk exposure in order to qualify for hedge accounting. When the terms of an underlying transaction are modified, or when the underlying hedged item ceases to exist, all changes in the fair value of the instrument are included in net income for each period until the derivative instrument matures or is settled. Any derivative instrument used for risk management that does not meet the hedging criteria is carried at fair value with the changes in value included in net income.

Derivatives will be used for economic hedging purposes rather than speculation. We will rely on quotations from third parties to determine fair values. If our hedging activities do not achieve our desired results, our reported earnings may be adversely affected.

Reserve for Possible Credit Losses

The expense for possible credit losses in connection with debt investments is the charge to earnings to increase the allowance for possible credit losses to the level that management estimates to be adequate considering delinquencies, loss experience and collateral quality. Other factors considered relate to geographic trends and product diversification, the size of the portfolio and current economic conditions. Based upon these factors, we establish the provision for possible credit losses by category of asset. When it is probable that we will be unable to collect all amounts contractually due, the account is considered impaired.

25

Where impairment is indicated, a valuation write-down or write-off is measured based upon the excess of the recorded investment amount over the net fair value of the collateral, as reduced by selling costs. Any deficiency between the carrying amount of an asset and the net sales price of repossessed collateral is charged to the allowance for credit losses.

Income Taxes

We intend to elect and qualify to be taxed as a REIT. Accordingly, we will generally not be subject to corporate federal or state income tax to the extent that we make qualifying distributions to our stockholders, and provided we satisfy on a continuing basis, through actual investment and operating results, the REIT requirements including certain asset, income, distribution and stock ownership tests. If we fail to qualify as a REIT, and do not qualify for certain statutory relief provisions, we will be subject to federal, state and local income taxes and may be precluded from qualifying as a REIT for the subsequent four taxable years following the year in which we lost our REIT qualification. Accordingly, our failure to qualify as a REIT could have a material adverse impact on our results of operations and amounts available for distribution to our stockholders.

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

The dividends paid deduction of a REIT for qualifying dividends to its stockholders is computed using our taxable income as opposed to net income reported on the financial statements. Taxable income, generally, will differ from net income reported on the financial statements because the determination of taxable income is based on tax provisions and not financial accounting principles.

In the future, we may create subsidiaries and treat them as taxable REIT subsidiaries, or TRSs. In general, a TRS of ours may hold assets and engage in activities that we cannot hold or engage in directly and generally may engage in any real estate or non-real estate-related business. A TRS is subject to federal, state and local corporate income taxes.

While our TRS will generate net income, our TRS can declare dividends to us which will be included in our taxable income and necessitate a distribution to our stockholders. Conversely, if we retain earnings at the TRS level, no distribution is required and we can increase book equity of the consolidated entity.

Financial Condition

At June 30, 2008, our portfolio consisted of \$1.1 billion of RMBS and of approximately \$150.0 million of whole mortgage loans.

The following table summarizes certain characteristics of our portfolio at June 30, 2008 and December 31, 2007.

| | June 30, 2008 | December 31, 2007 |
|---|------------------|----------------------|
| ----- | | |
| Leverage at period-end | 3.6:1 | 0.5:1 |
| Residential mortgage-backed securities as a % of portfolio | 61.8% | 87.5% |
| Residential mortgage loans as a % of portfolio | 7.7% | 12.5% |
| Loans collateralizing secured debt as a % of portfolio | 30.5% | - |
| Fixed-rate investments as % of portfolio | 20.0% | 14.4% |
| Adjustable-rate investments as % of portfolio | 80.0% | 85.6% |
| Fixed-rate investments | | |
| Residential mortgage-backed securities as a % of fixed-rate assets | 16.0% | 39.5% |
| Residential mortgage loans as a % of fixed-rate assets | 15.2% | 60.5% |
| Loans collateralizing secured debt as a % of fixed-rate assets | 68.8% | - |
| Adjustable-rate investments | | |
| Residential mortgage-backed securities as a % of adjustable-rate assets | 73.2% | 95.5% |
| Residential mortgage loans as a % of adjustable-rate assets | 5.8% | 4.5% |

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

| | | |
|---|-------|-------|
| Loans collateralizing secured debt as a % of adjustable-rate assets | 21.0% | - |
| Annualized yield on average earning assets during the period | 6.18% | 7.02% |
| Annualized cost of funds on average repurchase agreements balance during the period | 5.53% | 5.08% |
| Annualized interest rate spread during the period | 0.65% | 1.94% |
| Weighted average yield on assets at period-end | 6.18% | 6.62% |
| Weighted average cost of funds at period-end | 5.35% | 5.02% |
| Residential Mortgage-Backed Securities | | |

The table below summarizes our RMBS investments at June 30, 2008 and December 31, 2007:

| | June 30, 2008 | December 31, 2007 |
|------------------------|---------------------|----------------------|
| (dollars in thousands) | | |
| Amortized cost | \$ 1,221,567 | \$ 1,114,137 |
| Unrealized gains | - | 10,675 |
| Unrealized losses | (104,981) | (522) |
| Fair value | \$ 1,116,586 | \$ 1,124,290 |

As of June 30, 2008, the RMBS in our portfolio were purchased at a net discount to their par value. Our RMBS had a weighted average amortized cost of 99.4% and 98.8% at June 30, 2008 and December 31, 2007, respectively.

The following tables summarize certain characteristics of our RMBS portfolio at June 30, 2008 and December 31, 2007.

| | Estimated Value (dollars in thousands) (1) | Weighted Averages | | |
|-------------------|--|-------------------|----------------------|-----------------------------------|
| | | Coupon | Yield to Maturity | Constant Prepayment Rate(2) |
| June 30, 2008 | \$ 1,116,586 | 6.27% | 6.53% | 13% |
| December 31, 2007 | \$ 1,124,290 | 6.32% | 6.87% | 10% |

(1) All assets listed in this chart are carried at their fair value.

(2) Represents the estimated percentage of principal that will be prepaid over the next three months based on historical principal paydowns.

All of our RMBS investments June 30, 2008 and December 31, 2007 carried actual or implied AAA credit ratings.

Actual maturities of RMBS are generally shorter than stated contractual maturities, as they are affected by the contractual lives of the underlying mortgages, periodic payments of principal, and prepayments of principal. The stated contractual final maturity of the mortgage loans underlying our portfolio of RMBS ranges up to 40 years, but the expected maturity is subject to change based on the prepayments of the underlying loans. As of June 30, 2008, the average final contractual maturity of the RMBS portfolio is 31 years, and as of December 31, 2007, it was 29 years. The estimated weighted average months to maturity of the RMBS in the tables below are based upon our prepayment expectations, which are based on both proprietary and subscription-based financial models. Our prepayment projections consider current and expected trends in interest rates, interest rate volatility, steepness of the yield curve, the mortgage rate of the outstanding loan, time to reset and the spread margin of the reset.

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

The constant prepayment rate, or CPR, attempts to predict the percentage of principal that will be prepaid over a period of time. We calculate average CPR on a quarterly basis based on historical principal paydowns. As interest rates rise, the rate of refinancings typically declines, which we expect may result in lower rates of prepayment and, as a result, a lower portfolio CPR. Conversely, as interest rates fall, the rate of refinancings typically increases, which we expect may result in higher rates of prepayment and, as a result, a higher portfolio CPR.

27

After the reset date, interest rates on our hybrid adjustable rate RMBS securities adjust annually based on spreads over various LIBOR and Treasury indices. These interest rates are subject to caps that limit the amount the applicable interest rate can increase during any year, known as periodic cap, and through the maturity of the applicable security, known as a lifetime cap. The weighted average periodic cap for the portfolio is an increase of 1.93% and the weighted average maximum lifetime increases and decreases for the portfolio are 12.18%.

The following table summarizes our RMBS according to their estimated weighted average life classifications as of June 30, 2008 and December 31, 2007:

| | Fair Value | |
|--|------------------------|----------------------|
| | June 30, 2008 | December 31, 2007 |
| | (dollars in thousands) | |
| | ----- | |
| Less than one year | - | \$ 45,868 |
| Greater than one year and less than five years | \$ 1,071,852 | 1,078,422 |
| Greater than or equal to five years | 44,734 | - |
| | ----- | |
| Total | \$ 1,116,586 | \$ 1,124,290 |
| | ===== | |

Mortgage Loan Portfolio Characteristics

The following tables present certain characteristics of our mortgage loan portfolio as of June 30, 2008.

| (dollars in thousands) | |
|---|------------|
| | ----- |
| Original loan balance | \$ 153,966 |
| Unpaid principal balance | \$ 152,315 |
| Weighted average coupon rate on loans | 5.77% |
| Weighted average original term (years) | 28.9 |
| Weighted average remaining term (years) | 28.7 |

| Geographic Distribution | Remaining Balance | | % of Loan Portfolio | Loan Count |
|-------------------------|------------------------|------------------------|---------------------|------------|
| | (dollars in thousands) | (dollars in thousands) | | |
| Top 5 States | | | | |
| | ----- | | | |
| CA | \$ 35,854 | | 23.54% | 50 |

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

| | | | | |
|-------|----|--------|--------|-----|
| IL | | 14,947 | 9.81% | 23 |
| NJ | | 11,642 | 7.64% | 18 |
| SC | | 6,968 | 4.57% | 8 |
| NY | | 6,741 | 4.43% | 10 |
| Total | \$ | 76,152 | 49.99% | 109 |

| Occupancy Status | Remaining Balance (dollars in thousands) | % of Loan Portfolio | Loan Count | Loan Purpose | % of Loan Portfolio |
|------------------|---|---------------------|------------|-------------------------|---------------------|
| Owner occupied | \$137,546 | 90.30% | 196 | Purchase | 50.5 |
| Second home | 14,330 | 9.41% | 19 | Cash out refinance | 18.1 |
| Investor | 439 | .29% | 1 | Rate and term refinance | 31.4 |
| Total | \$152,315 | 100.00% | 216 | | 100.0 |

28

| Documentation Type | % of Loan Portfolio | ARM Loan Type | % of ARM Loan |
|------------------------|---------------------|-----------------------|---------------|
| Full/alternative | 77.13% | Traditional ARM loans | |
| Stated income/no ratio | 22.87% | Hybrid ARM loans | 100.00 |
| Total | 100.00% | Total | 100.00 |

| Unpaid Principal Balance | Dollars in Thousands | FICO Score | % of Loan Portfolio |
|----------------------------|----------------------|----------------------------|---------------------|
| \$417,000 or less | \$ 394 | 740 and above | 59.50% |
| \$417,001 to \$650,000 | 66,399 | 700 to 739 | 25.35% |
| \$650,001 to \$1,000,000 | 66,471 | 660 to 699 | 13.30% |
| \$1,000,001 to \$2,000,000 | 19,051 | 620 to 659 | .33% |
| \$2,000,001 to \$3,000,000 | - | Below 620 or not available | 1.52% |
| Over \$3,000,001 | - | Total | 100.00% |
| Total | \$ 152,315 | | |

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

Weighted Average FICO Score 748.97

| Original Loan to Value Ratio | Dollars in Thousands | Property Type | % of Loan Portfolio |
|------------------------------|----------------------|---------------------------|---------------------|
| 80.01% and above | \$ 24,881 | Single-family | 62.79% |
| 70.01% to 80.00% | 79,330 | Planned urban development | 27.97% |
| 60.01% to 70.00% | 16,794 | Condominium | 4.18% |
| 60.00% or less | 31,310 | Other residential | 5.06% |
| Total | \$ 152,315 | Total | 100.00% |

Weighted Average Original Loan to Value Ratio 72.30

| Periodic Cap on Hybrid ARM Loans | % of ARM Loans |
|----------------------------------|----------------|
| 3.00% or less | 100.00% |
| 3.01% to 4.00% | -- |
| 4.01% to 5.00% | -- |
| Total | 100.00% |

Weighted Average Original Loan to Value Ratio 72.30

We purchase our mortgage loans on a servicing retained basis. As a result, we do not service any loans, or receive any servicing income.

Results of Operations for the Quarter and Six Months Ended June 30, 2008 (No Comparable Information for 2007)

Net Income/Loss Summary

Our net income for the quarter ended June 30, 2008 was \$33.9 million, or \$0.87 per average share. Our income for this quarter consisted primarily of interest income and unrealized gains on interest rate swaps.

For the six months ended, June 30, 2008, our net loss was \$21.0 million, or (\$0.54) per average share. We attribute the net loss for the six months ended June 30, 2008 primarily to unrealized losses on our interest rate swaps due to fair value adjustments and realized losses on sales of investments.

The table below presents the net income/loss summary for the quarter and six months ended June 30, 2008:

Net Income/Loss Summary
(dollars in thousands, except for per share data)

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

| | For the Quarter Ended June 30, 2008 | For the Six Months Ended June 30, 2008 |
|--|---|--|
| Interest income | \$ 29,951 | \$ 58,145 |
| Interest expense | 20,025 | 34,047 |
| Net interest income | 9,926 | 24,098 |
| Unrealized gains (losses) on interest rate swaps | 25,584 | (5,909) |
| Realized gains (losses) on sales of investments | 1,644 | (31,175) |
| Realized gain on terminations of interest rate swaps | 123 | 123 |
| Net investment income (loss) | 37,277 | (12,863) |
| Expenses | | |
| Management fee | 2,228 | 4,455 |
| General and administrative expenses | 1,152 | 3,718 |
| Total expenses | 3,380 | 8,173 |
| Gain (loss) before income taxes | 33,897 | (21,036) |
| Income taxes | - | 3 |
| Net income (loss) | \$ 33,897 | \$ (21,039) |
| Net income (loss) per share - basic and diluted | \$ 0.87 | \$ (0.54) |
| Weighted average number of shares outstanding - basic and diluted | 38,999,850 | 38,995,096 |
| Comprehensive Income (Loss): | | |
| Net income (loss) | 33,897 | (21,039) |
| Other comprehensive loss: | | |
| Unrealized loss on available-for-sale securities | | |
| Other comprehensive income: | (58,051) | (136,155) |
| Reclassification adjustment for realized (gains) losses included in net income | (1,644) | 31,175 |
| Other comprehensive loss | (59,695) | (104,980) |
| Comprehensive loss | \$ (25,798) | \$ (126,019) |

Interest Income and Average Earning Asset Yield

We had average earning assets of \$1.9 billion for the quarter ended June 30, 2008. Our interest income was \$30.0 million for the quarter ended June 30, 2008. The yield on our portfolio was 6.18% for the quarter ended June 30, 2008. We had average earning assets of \$1.7 billion for the six months ending June 30, 2008. Our interest income for this six month period was \$58.1 million. The yield on our portfolio was 6.38% for this six month period.

Interest Expense and the Cost of Funds

Our largest expense is the cost of borrowed funds. We had average borrowed funds of \$1.5 billion and total interest expense of \$20.0 million for the quarter ended June 30, 2008. Our average cost of funds was 5.53% for the quarter ended June 30, 2008. We had average borrowed funds of \$1.4 billion and total interest expense of \$34.0 million for the six months ending June 30, 2008. Our average cost of funds was 4.91% for the six months ending June 30, 2008. We attribute the increase in interest expense to the increase in our interest rate swap expense and an increase in weighted average rate we paid to finance our assets.

The table below shows our average borrowed funds and average cost of funds as compared to average one-month and average six-month LIBOR for the quarters ended March 31, 2008 and June 30, 2008, and the period commencing November 21, 2007 (inception) and ending December 31, 2007.

Average Cost of Funds
(Ratios have been annualized, dollars in thousands)

| | Average Borrowed Funds | Interest Expense | Average Cost of Funds | Average One-Month LIBOR | Average Six Month LIBOR |
|--|---------------------------|---------------------|-----------------------------|-------------------------------|----------------------------------|
| For the quarter ended June 30, 2008 | \$ 1,449,567 | \$ 20,025 | 5.53% | 2.59% | 2.9 |
| For the quarter ended March 31, 2008 | \$ 1,325,156 | \$ 14,022 | 4.23% | 3.31% | 3.1 |
| For the period ended December 31, 2007 | \$ 270,584 | \$ 415 | 5.08% | 4.98% | 4.8 |

Net Interest Income

Our net interest income, which equals interest income less interest expense, totaled \$9.9 million for the quarter ended June 30, 2008. Our net interest spread, which equals the yield on our average assets for the period less the average cost of funds for the period, was 0.65% for the quarter ended June 30, 2008. Our net interest income totaled \$24.1 million for the six months ended June 30, 2008. Our net interest spread for this six month period was 1.47%.

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

The table below shows our average assets held, total interest earned on assets, yield on average interest earning assets, average balance of repurchase agreements, interest expense, average cost of funds, net interest income, and net interest rate spread for the quarters ended March 31, 2008 and June 30, 2008, and the period commencing November 21, 2007 and ending December 31, 2007.

31

Net Interest Income (Ratios have been annualized, dollars in thousands)

| | Average Earning Assets Held | Interest Earned on Assets | Yield on Average Interest Earning Assets | Average Balance of Repurchase Agreements | Interest Expense |
|--|--------------------------------|---------------------------------|--|--|---------------------|
| For the Quarter Ended June 30, 2008 | \$ 1,917,969 | \$ 29,630 | 6.18% | \$ 1,449,567 | \$ 20,025 |
| For the Quarter Ended March 31, 2008 | \$ 1,555,896 | \$ 25,790 | 6.63% | \$ 1,325,156 | \$ 14,022 |
| For the Period Ended December 31, 2007 | \$ 399,736 | \$ 3,492 | 7.02% | \$ 270,584 | \$ 415 |

Gains and Losses on Sales of Assets and Interest Rate Swaps

For the quarter ended June 30, 2008, we did not sell assets. For the six months ended June 30, 2008, we sold assets with a carrying value of \$369.9 million for an aggregate loss of \$31.2 million.

Management Fee and General and Administrative Expenses

We paid FIDAC a base management fee of \$2.2 million for the quarter ended June 30, 2008. We did not pay an incentive fee for the quarter ended June 30, 2008. We paid FIDAC a base management fee of \$4.5 million for the six months ended June 30, 2008 and did not pay it an incentive fee for this six month period.

General and administrative (or G&A) expenses were \$1.2 million for the quarter ended June 30, 2008 and \$3.7 million for the six months ended June 30, 2008.

Total expenses as a percentage of average total assets were 0.70% for the quarter ended June 30, 2008 and were 0.89% for the six months ended June 30, 2008.

Currently, FIDAC has waived its right to require us to pay our pro rata portion of rent, telephone, utilities, office furniture, equipment, machinery and other office, internal and overhead expenses of FIDAC and its affiliates required for our operations.

The table below shows our total management fee and G&A expenses as compared to average total assets and average equity for the quarters ended March 31, 2008 and June 30, 2008, and the period commencing November 21, 2007 and

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

ending December 31, 2007.

Management Fee and G&A Expenses and Operating Expense Ratios (Ratios have been annualized, dollars in thousands)

| | Total Management Fee and G&A Expenses | Total Management Fee and G&A Expenses/Average Total Assets | Total Management Fee and G&A Expenses/Average Equity |
|---|--|---|---|
| For the Quarter ended June 30, 2008 | \$ 3,380 | 0.70% | 3.35% |
| For the Quarter ended March 31, 2008 | \$ 4,792 | 1.10% | 4.00% |
| For the Period Commencing November 21, 2007 and Ending December 31, 2007 | \$ 1,822 | 1.55% | 3.05% |

Net Income/Loss and Return on Average Equity

Our net income (loss) was \$33.9 million for the quarter ended June 30, 2008, and (\$21.0) million for the six months ended June 30, 2008. We attribute the losses incurred during the six months ended June 30, 2008 to realized losses on sales of investments and unrealized losses on interest rate swaps. The table below shows our net interest income, gain (loss) on sale of assets, unrealized gains (loss) on interest rate swaps, total expenses, income tax, each as a percentage of average equity, and the return on average equity for the quarters ended June 30, 2008, March 31, 2008, and the period commencing November 21, 2007 and ending December 31, 2007.

32

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

| | Net Interest Income/Average Equity | Gain/(Loss) on Sale of Investments /Average Equity | Unrealized Gain/(Loss) on Interest Rate Swaps/Average Equity | Total Expenses/ Equity |
|--|--|--|---|------------------------------|
| For the Quarter ended June 30, 2008 | 9.84% | 1.75% | 25.36% | |
| For the Quarter ended March 31, 2008 | 11.83% | (27.40%) | (26.29%) | |
| For the Period Commencing November 21, 2007 and Ending December 31, 2007 | 5.16% | - | (6.97%) | |

Liquidity and Capital Resources

We held cash and cash equivalents of approximately \$49.9 million at June

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

30, 2008.

Our operating activities provided net cash of approximately \$7.6 million for the quarter ended June 30, 2008. We generated net cash of approximately \$15.6 million from operations for the six months ended June 30, 2008.

Our investing activities used net cash of \$13.1 million for the quarter ended June 30, 2008, and net cash of \$1.1 billion for the six months ended June 30, 2008. We used this cash primarily for the purchase of investments.

Our financing activities as of June 30, 2008 consisted of proceeds from repurchase agreements, as well as the debt obligations of a \$619.7 million securitization we completed during the quarter. We expect to continue to borrow funds in the form of repurchase agreements as well as other types of financing. As of June 30, 2008 we had established repurchase agreements for RMBS with 14 counterparties, including Annaly. As of June 30, 2008, we had \$50 million outstanding under our repurchase agreement with Annaly. As of August 6, 2008, we had \$606 million outstanding under this agreement, which constitutes approximately 48% of our total financing. The terms of the repurchase transaction borrowings under our master repurchase agreements generally conform to the terms in the standard master repurchase agreement as published by the Securities Industry and Financial Markets Association, or SIFMA, as to repayment, margin requirements and the segregation of all securities we have initially sold under the repurchase transaction. In addition, each lender typically requires that we include supplemental terms and conditions to the standard master repurchase agreement. Typical supplemental terms and conditions include changes to the margin maintenance requirements, required haircuts, and purchase price maintenance requirements, requirements that all controversies related to the repurchase agreement be litigated in a particular jurisdiction and cross default provisions. These provisions will differ for each of our lenders and will not be determined until we engage in a specific repurchase transaction. We had also established two repurchase agreements for whole mortgage loans as of June 30, 2008, which were terminated subsequent to the end of the quarter.

We had outstanding \$909.0 million in repurchase agreements collateralized by our RMBS with weighted average borrowing rates of 4.85% and weighted average remaining maturities of 23 days as of June 30, 2008. The RMBS pledged as collateral under these repurchase agreements had an estimated fair value of \$911.7 million at June 30, 2008. The interest rates of these repurchase agreements are generally indexed to the one-month LIBOR rate and reprice accordingly.

At June 30, 2008 and March 31, 2008, the repurchase agreements for RMBS had the following remaining maturities:

| | June 30, 2008 | March 31, 2008 | |
|-----------------------------------|------------------------|----------------|-------|
| | (dollars in thousands) | | |
| ----- | | | ----- |
| Within 30 days | \$ 539,603 | \$ 598,168 | |
| 30 to 59 days | 344,972 | 384,964 | |
| 60 to 89 days | - | - | |
| 90 to 119 days | 24,514 | - | |
| Greater than or equal to 120 days | - | 24,514 | |
| ----- | | | ----- |
| Total | \$ 909,089 | \$ 1,007,646 | |
| | ===== | | |

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

We had entered into two master repurchase agreements pursuant to which we financed mortgage loans. Subsequent to June 30, 2008, we terminated these agreements in order to avoid paying non-usage fees under those agreements. One agreement was a \$500 million lending facility of which \$200 million was on an uncommitted basis. The second agreement was a \$350 million committed lending facility. As of June 30, 2008, we had no amounts borrowed against these facilities.

Increases in short-term interest rates could negatively affect the valuation of our mortgage-related assets, which could limit our borrowing ability or cause our lenders to initiate margin calls. Amounts due upon maturity of our repurchase agreements will be funded primarily through the rollover/reissuance of repurchase agreements and monthly principal and interest payments received on our mortgage-backed securities.

For our short-term (one year or less) and long-term liquidity, which includes investing and compliance with collateralization requirements under our repurchase agreements (if the pledged collateral decreases in value or in the event of margin calls created by prepayments of the pledged collateral), we also rely on the cash flow from investments, primarily monthly principal and interest payments to be received on our RMBS and whole mortgage loans, cash flow from the sale of securities as well as any primary securities offerings authorized by our board of directors.

Based on our current portfolio, leverage ratio and available borrowing arrangements, we believe our assets will be sufficient to enable us to meet anticipated short-term (one year or less) liquidity requirements such as to fund our investment activities, pay fees under our management agreement, fund our distributions to stockholders and pay general corporate expenses. However, an increase in prepayment rates substantially above our expectations could cause a temporary liquidity shortfall due to the timing of the necessary margin calls on the financing arrangements and the actual receipt of the cash related to principal paydowns. If our cash resources are at any time insufficient to satisfy our liquidity requirements, we may have to sell investments or issue debt or additional equity securities in a common stock offering. If required, the sale of RMBS or whole mortgage loans at prices lower than their carrying value would result in losses and reduced income.

Our ability to meet our long-term (greater than one year) liquidity and capital resource requirements will be subject to obtaining additional debt financing and equity capital. Subject to our maintaining our qualification as a REIT, we expect to use a number of sources to finance our investments, including repurchase agreements, warehouse facilities, securitizations, commercial paper and term financing CDOs. Such financing will depend on market conditions for capital raises and for the investment of any proceeds. If we are unable to renew, replace or expand our sources of financing on substantially similar terms, it may have an adverse effect on our business and results of operations. Upon liquidation, holders of our debt securities, if any, and shares of preferred stock, if any, and lenders with respect to other borrowings will receive a distribution of our available assets prior to the holders of our common stock.

We are not required by our investment guidelines to maintain any specific debt-to-equity ratio as we believe the appropriate leverage for the particular assets we are financing depends on the credit quality and risk of those assets. However, our repurchase agreements for whole loans require us to maintain certain debt-to-equity ratios. At June 30, 2008, our total debt was approximately \$1.4 billion which represented a debt-to-equity ratio of approximately 3.6:1.

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

Stockholders' Equity

During the quarter ended June 30, 2008, we declared dividends to common shareholders totaling \$6.0 million, or \$0.16 per share, all of which was paid on July 31, 2008.

Management Agreement and Related Party Transactions

34

We have entered into a management agreement with FIDAC, pursuant to which FIDAC is entitled to receive a base management fee, incentive compensation and, in certain circumstances, a termination fee and reimbursement of certain expenses as described in the management agreement. Such fees and expenses do not have fixed and determinable payments. The base management fee is payable quarterly in arrears in an amount equal to 1.75% per annum, calculated quarterly, of our stockholders' equity (as defined in the management agreement). FIDAC uses the proceeds from its management fee in part to pay compensation to its officers and employees who, notwithstanding that certain of them also are our officers, receive no cash compensation directly from us. The base management fee will be reduced, but not below zero, by our proportionate share of any CDO base management fees FIDAC receives in connection with the CDOs in which we invest, based on the percentage of equity we hold in such CDOs. FIDAC will receive quarterly incentive compensation in an amount equal to 20% of the dollar amount by which Core Earnings, on a rolling four-quarter basis and before the incentive management fee, exceeds the product of (1) the weighted average of the issue price per share of all of our public offerings multiplied by the weighted average number of shares of common stock outstanding in such quarter and (2) 0.50% plus one-fourth of the average of the one month LIBOR rate for such quarter and the previous three quarters. For the initial four quarters following this offering, Core Earnings and the LIBOR rate will be calculated on the basis of each of the previously completed quarters on an annualized basis. Core Earnings is a non-GAAP measure and is defined as GAAP net income (loss) excluding non-cash equity compensation expense, excluding any unrealized gains, losses or other items that do not affect realized net income (regardless of whether such items are included in other comprehensive income or loss, or in net income). The amount will be adjusted to exclude one-time events pursuant to changes in GAAP and certain non-cash charges after discussions between FIDAC and our independent directors and approval by a majority of our independent directors. The incentive management fee will be reduced, but not below zero, by our proportionate share of any CDO incentive management fees FIDAC receives in connection with the CDOs in which we invest, based on the percentage of equity we hold in such CDOs. We expect to enter into certain contracts that contain a variety of indemnification obligations, principally with FIDAC, brokers and counterparties to repurchase agreements. The maximum potential future payment amount we could be required to pay under these indemnification obligations is unlimited.

Financing Arrangements with Annaly

In March 2008, we entered into a RMBS repurchase agreement with Annaly. This agreement contains customary representations, warranties and covenants contained in such agreements. As of June 30, 2008, we had \$50 million outstanding under the agreement with a weighted average borrowing rate of 3.96%. As of August 6, 2008, we had \$606 million outstanding under this agreement, which constitutes approximately 48% of our total financing. At March 31, 2008, we had no obligation under this agreement.

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

Restricted Stock Grants

During the quarter ended June 30, 2008, 32,300 shares of restricted stock we had awarded to our Manager's employees vested and 4,768 shares were forfeited or cancelled. We did not grant any incentive awards during the quarter ended June 30, 2008.

At June 30, 2008 there are approximately \$1.3 million unvested shares of restricted stock issued to employees of FIDAC. For the three months ended June 30, 2008, compensation expense less general and administrative costs associated with the amortization of the fair value of the restricted stock totaled \$337 thousand.

Contractual Obligations and Commitments

The following table summarizes our contractual obligations at June 30, 2008.

| (dollars in thousands) | | | | | |
|--|--------------------|--------------------------|------------------------|---|--------------------|
| Contractual Obligations | Within One Year | One to Three Years | Three to Five Years | Greater Than or Equal to Five Years | Total |
| Repurchase agreements for RMBS Securitized debt | \$ 909,089 | \$ - | \$ - | \$ - | \$ 909,089 |
| Interest expense on RMBS repurchase agreements(1) | 93,635 | 173,874 | 105,023 | 152,939 | 525,471 |
| Interest expense on securitized debt | 19 | - | - | - | 19 |
| | 31,333 | 51,501 | 30,765 | 227,994 | 341,593 |
| Total | \$1,034,076 | \$ 225,375 | \$ 135,788 | \$ 380,933 | \$1,776,172 |

(1) Interest is based on rates in effect as of June 30, 2008.

35

Off-Balance Sheet Arrangements

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

Dividends

To qualify as a REIT, we must pay annual dividends to our stockholders of at least 90% of our taxable income, determined without regard to the deduction

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

for dividends paid and excluding any net capital gains. We intend to pay regular quarterly dividends to our stockholders. Before we pay any dividend, whether for U.S. federal income tax purposes or otherwise, which would only be paid out of available cash to the extent permitted under our warehouse and repurchase facilities, we must first meet both our operating requirements and scheduled debt service on our warehouse lines and other debt payable.

Inflation

Virtually all of our assets and liabilities are interest rate sensitive in nature. As a result, interest rates and other factors influence our performance far more so 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 distributions will be determined by our board of directors consistent with our obligation to distribute to our stockholders at least 90% of our REIT taxable income on an annual basis in order to maintain our REIT qualification; in each case, our activities and balance sheet are measured with reference to historical cost and/or fair market value without considering inflation.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The primary components of our market risk are related to credit risk, interest rate risk, prepayment risk, market value risk and real estate risk. While we do not seek to avoid risk completely, we believe the risk can be quantified from historical experience and we seek to actively manage that risk, to earn sufficient compensation to justify taking those risks and to maintain capital levels consistent with the risks we undertake.

Credit Risk

We are subject to credit risk in connection with our investments and face more credit risk on assets we own which are rated below "AAA". The credit risk related to these investments pertains to the ability and willingness of the borrowers to pay, which is assessed before credit is granted or renewed and periodically reviewed throughout the loan or security term. We believe that residual loan credit quality is primarily determined by the borrowers' credit profiles and loan characteristics. FIDAC will use a comprehensive credit review process. FIDAC's analysis of loans includes borrower profiles, as well as valuation and appraisal data. FIDAC uses compensating factors such as liquid assets, low loan to value ratios and job stability in evaluating loans. FIDAC's resources include a proprietary portfolio management system, as well as third party software systems. FIDAC utilizes third party due diligence firms to perform an independent underwriting review to insure compliance with existing guidelines. FIDAC selects loans for review predicated on risk-based criteria such as loan-to-value, borrower's credit score(s) and loan size. FIDAC also outsources underwriting services to review higher risk loans, either due to borrower credit profiles or collateral valuation issues. In addition to statistical sampling techniques, FIDAC creates adverse credit and valuation samples, which we individually review. FIDAC rejects loans that fail to conform to our standards. FIDAC accepts only those loans which meet our underwriting criteria. Once we own a loan, FIDAC's surveillance process includes ongoing analysis through our proprietary data warehouse and servicer files. Additionally, the non-Agency RMBS and other ABS which we will acquire for our portfolio are reviewed by FIDAC to ensure that they satisfy our risk based criteria. FIDAC's review of non-Agency RMBS and other ABS includes utilizing its proprietary portfolio management system. FIDAC's review of non-Agency RMBS and other ABS is based on quantitative and qualitative analysis of the risk-adjusted returns on non-Agency RMBS and other ABS present.

Interest Rate Risk

Interest rate risk is highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political considerations and other factors beyond our control. We are subject to interest rate risk in connection with our investments and our related debt obligations, which are generally repurchase agreements, warehouse facilities, securitization, commercial paper and term financing CDOs. Our repurchase agreements and warehouse facilities may be of limited duration that are periodically refinanced at current market rates. We intend to mitigate this risk through utilization of derivative contracts, primarily interest rate swap agreements.

Interest Rate Effect on Net Interest Income

Our operating results depend, in large part, on differences between the income from our investments and our borrowing costs. Most of our warehouse facilities and repurchase agreements provide financing based on a floating rate of interest calculated on a fixed spread over LIBOR. The fixed spread varies depending on the type of underlying asset which collateralizes the financing. Accordingly, the portion of our portfolio which consists of floating interest rate assets will be match-funded utilizing our expected sources of short-term financing, while our fixed interest rate assets will not be match-funded. During periods of rising interest rates, the borrowing costs associated with our investments tend to increase while the income earned on our fixed interest rate investments may remain substantially unchanged. This will result in a narrowing of the net interest spread between the related assets and borrowings and may even result in losses. Further, during this portion of the interest rate and credit cycles, defaults could increase and result in credit losses to us, which could adversely affect our liquidity and operating results. Such delinquencies or defaults could also have an adverse effect on the spread between interest-earning assets and interest-bearing liabilities. Hedging techniques are partly based on assumed levels of prepayments of our fixed-rate and hybrid adjustable-rate mortgage loans and RMBS. If prepayments are slower or faster than assumed, the life of the mortgage loans and RMBS will be longer or shorter, which would reduce the effectiveness of any hedging strategies we may use and may cause losses on such transactions. Hedging strategies involving the use of derivative securities are highly complex and may produce volatile returns.

Interest Rate Effects on Fair Value

Another component of interest rate risk is the effect changes in interest rates will have on the fair value of the assets we acquire. We face the risk that the fair value of our assets will increase or decrease at different rates than that of our liabilities, including our hedging instruments. We primarily assess our interest rate risk by estimating the duration of our assets and the duration of our liabilities. Duration essentially measures the market price volatility of financial instruments as interest rates change. We generally calculate duration using various financial models and empirical data. Different models and methodologies can produce different duration numbers for the same securities.

It is important to note that the impact of changing interest rates on fair value can change significantly when interest rates change beyond 100 basis points from current levels. Therefore, the volatility in the fair value of our assets could increase significantly when interest rates change beyond 100 basis points. In addition, other factors impact the fair value of our interest rate-sensitive investments and hedging instruments, such as the shape of the yield curve, market expectations as to future interest rate changes and other

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

market conditions. Accordingly, in the event of changes in actual interest rates, the change in the fair value of our assets would likely differ from that shown above and such difference might be material and adverse to our stockholders.

Interest Rate Cap Risk

37

We also invest in adjustable-rate mortgage loans and RMBS. These are mortgages or RMBS in which the underlying mortgages are typically subject to periodic and lifetime interest rate caps and floors, which limit the amount by which the security's interest yield may change during any given period. However, our borrowing costs pursuant to our financing agreements will not be subject to similar restrictions. Therefore, in a period of increasing interest rates, interest rate costs on our borrowings could increase without limitation by caps, while the interest-rate yields on our adjustable-rate mortgage loans and RMBS would effectively be limited. This problem will be magnified to the extent we acquire adjustable-rate RMBS that are not based on mortgages which are fully indexed. In addition, the mortgages or the underlying mortgages in an RMBS may be subject to periodic payment caps that result in some portion of the interest being deferred and added to the principal outstanding. This could result in our receipt of less cash income on our adjustable-rate mortgages or RMBS than we need in order to pay the interest cost on our related borrowings. These factors could lower our net interest income or cause a net loss during periods of rising interest rates, which would harm our financial condition, cash flows and results of operations.

Interest Rate Mismatch Risk

We fund a substantial portion of our acquisitions of hybrid adjustable-rate mortgages and RMBS with borrowings that, after the effect of hedging, have interest rates based on indices and repricing terms similar to, but of somewhat shorter maturities than, the interest rate indices and repricing terms of the mortgages and RMBS. Thus, in most cases the interest rate indices and repricing terms of our mortgage assets and our funding sources will not be identical, thereby creating an interest rate mismatch between assets and liabilities. Therefore, our cost of funds would likely rise or fall more quickly than would our earnings rate on assets. During periods of changing interest rates, such interest rate mismatches could negatively impact our financial condition, cash flows and results of operations. To mitigate interest rate mismatches, we may utilize the hedging strategies discussed above. Our analysis of risks is based on FIDAC's experience, estimates, models and assumptions. These analyses rely on models which utilize estimates of fair value and interest rate sensitivity. Actual economic conditions or implementation of investment decisions by our management may produce results that differ significantly from the estimates and assumptions used in our models and the projected results shown in this Form 10-Q.

Our profitability and the value of our portfolio (including interest rate swaps) may be adversely affected during any period as a result of changing interest rates. The following table quantifies the potential changes in net interest income, portfolio value should interest rates go up or down 25, 50, and 75 basis points, assuming the yield curves of the rate shocks will be parallel to each other and the current yield curve. All changes in income and value are measured as percentage changes from the projected net interest income and portfolio value at the base interest rate scenario. The base interest rate scenario assumes interest rates at June 30, 2008 and various estimates regarding prepayment and all activities are made at each level of rate shock. Actual

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

results could differ significantly from these estimates.

| Change in Interest Rate | Projected Percentage Change in Net Interest Income | Projected Percentage Change in Portfolio Value |
|-------------------------|--|--|
| -75 Basis Points | (9.28%) | 1.16% |
| -50 Basis Points | (6.34%) | 1.10% |
| -25 Basis Points | (3.20%) | 1.02% |
| Base Interest Rate | | |
| +25 Basis Points | 3.40% | 0.77% |
| +50 Basis Points | 6.82% | 0.61% |
| +75 Basis Points | 10.24% | 0.42% |

Prepayment Risk

As we receive prepayments of principal on these investments, premiums paid on such investments will be amortized against interest income. In general, an increase in prepayment rates will accelerate the amortization of purchase premiums, thereby reducing the interest income earned on the investments. Conversely, discounts on such investments are accreted into interest income. In general, an increase in prepayment rates will accelerate the accretion of purchase discounts, thereby increasing the interest income earned on the investments.

38

Extension Risk

FIDAC computes the projected weighted-average life of our investments based on assumptions regarding the rate at which the borrowers will prepay the underlying mortgages. In general, when fixed-rate or hybrid adjustable-rate mortgage loans or RMBS are acquired with borrowings, we may, but are not required to, enter into an interest rate swap agreement or other hedging instrument that effectively fixes our borrowing costs for a period close to the anticipated average life of the fixed-rate portion of the related assets. This strategy is designed to protect us from rising interest rates because the borrowing costs are fixed for the duration of the fixed-rate portion of the related assets. However, if prepayment rates decrease in a rising interest rate environment, the life of the fixed-rate portion of the related assets could extend beyond the term of the swap agreement or other hedging instrument. This could have a negative impact on our results from operations, as borrowing costs would no longer be fixed after the end of the hedging instrument while the income earned on the hybrid adjustable-rate assets would remain fixed. This situation may also cause the market value of our hybrid adjustable-rate assets to decline, with little or no offsetting gain from the related hedging transactions. In extreme situations, we may be forced to sell assets to maintain adequate liquidity, which could cause us to incur losses.

Market Risk

Market Value Risk

Our available-for-sale securities are reflected at their estimated fair value with unrealized gains and losses excluded from earnings and reported in other comprehensive income pursuant to SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities. The estimated fair value of these securities fluctuates primarily due to changes in interest rates and other

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

factors. Generally, in a rising interest rate environment, the estimated fair value of these securities would be expected to decrease; conversely, in a decreasing interest rate environment, the estimated fair value of these securities would be expected to increase. As market volatility increases or liquidity decreases, the fair value of our investments may be adversely impacted. If we are unable to readily obtain independent pricing to validate our estimated fair value of securities in the portfolio, the fair value gains or losses recorded in other comprehensive income may be adversely affected.

Real Estate Market Risk

We own assets secured by real property and may own real property directly in the future. Residential property values are subject to volatility and may be affected adversely by a number of factors, including, but not limited to, national, regional and local economic conditions (which may be adversely affected by industry slowdowns and other factors); local real estate conditions (such as an oversupply of housing); changes or continued weakness in specific industry segments; construction quality, age and design; demographic factors; and retroactive changes to building or similar codes. In addition, decreases in property values reduce the value of the collateral and the potential proceeds available to a borrower to repay our loans, which could also cause us to suffer losses.

Risk Management

To the extent consistent with maintaining our REIT status, we seek to manage risk exposure to protect our portfolio of residential mortgage loans, RMBS, and other assets and related debt against the effects of major interest rate changes. We generally seek to manage our risk by:

- o monitoring and adjusting, if necessary, the reset index and interest rate related to our RMBS and our financings;
- o attempting to structure our financing agreements to have a range of different maturities, terms, amortizations and interest rate adjustment periods;
- o using derivatives, financial futures, swaps, options, caps, floors and forward sales to adjust the interest rate sensitivity of our MBS and our borrowings;

39

- o using securitization financing to lower average cost of funds relative to short-term financing vehicles further allowing us to receive the benefit of attractive terms for an extended period of time in contrast to short term financing and maturity dates of the investments included in the securitization; and
- o actively managing, on an aggregate basis, the interest rate indices, interest rate adjustment periods, and gross reset margins of our investments and the interest rate indices and adjustment periods of our financings.

Our efforts to manage our assets and liabilities are concerned with the timing and magnitude of the repricing of assets and liabilities. We attempt to control risks associated with interest rate movements. Methods for evaluating interest rate risk include an analysis of our interest rate sensitivity "gap", which is the difference between interest-earning assets and interest-bearing

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

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

The following table sets forth the estimated maturity or repricing of our interest-earning assets and interest-bearing liabilities at June 30, 2008. The amounts of assets and liabilities shown within a particular period were determined in accordance with the contractual terms of the assets and liabilities, except adjustable-rate loans, and securities are included in the period in which their interest rates are first scheduled to adjust and not in the period in which they mature and does include the effect of the interest rate swaps. The interest rate sensitivity of our assets and liabilities in the table could vary substantially if based on actual prepayment experience.

| | Within 3 Months | 3-12 Months | 1 Year to 3 Years | Greater than 3 Years | Tot |
|--|--------------------|---------------------|----------------------|-------------------------|---------------------|
| (dollars in thousands) | | | | | |
| Rate sensitive assets | \$ - | \$ 49,623 | \$ 360,148 | \$ 1,578,257 | \$ 1,988,050 |
| Cash equivalents | 49,889 | - | - | - | 49,889 |
| Total rate sensitive assets | \$ 49,889 | \$ 49,623 | \$ 360,148 | \$ 1,578,257 | \$ 1,988,050 |
| Rate sensitive liabilities, with the effect of swaps | (19,684) | 214,117 | 598,656 | 641,471 | 1,457,668 |
| Interest rate sensitivity gap | \$ 69,573 | \$ (164,494) | \$ (238,508) | \$ 936,786 | \$ 593,357 |
| Cumulative rate sensitivity gap | \$ 69,573 | \$ (94,921) | \$ (333,429) | \$ 603,357 | \$ 258,580 |
| Cumulative interest rate sensitivity gap as a percentage of total rate- sensitive assets | 3% | (5%) | (16%) | 30% | |

Our analysis of risks is based on FIDAC's experience, estimates, models and assumptions. These analyses rely on models which utilize estimates of fair value and interest rate sensitivity. Actual economic conditions or implementation of investment decisions by FIDAC may produce results that differ significantly from the estimates and assumptions used in our models and the

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

projected results shown in the above tables and in this report. These analyses contain certain forward-looking statements and are subject to the safe harbor statement set forth under the heading, "Special Note Regarding Forward-Looking Statements."

40

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management, including our Chief Executive Officer, or CEO, and Chief Financial Officer, or CFO, reviewed and evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) of the Securities Exchange Act) as of the end of the period covered by this quarterly report. Based on that review and evaluation, the CEO and CFO have concluded that our current disclosure controls and procedures, as designed and implemented, (1) were effective in ensuring that information regarding the Company and its subsidiaries is made known to our management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure and (2) were effective in providing reasonable assurance that information the Company must disclose in its periodic reports under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods prescribed by the SEC's rules and forms.

Changes in Internal Controls

There have been no changes in our "internal control over financial reporting" (as defined in Rule 13a-15(f) under the Securities Exchange Act) that occurred during the period covered by this quarterly report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item. 1. LEGAL PROCEEDINGS

From time to time, we may be involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on our consolidated financial statements.

Item 1A. RISK FACTORS

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2007, which could materially affect our business, financial condition or future results. The information presented below updates and should be read in conjunction with the risk factors and information disclosed in that Form 10-K.

THE WEAKNESS IN THE MORTGAGE MARKET HAS CAUSED US TO EXPECT INCREASED MARKET LOSSES RELATED TO OUR HOLDINGS.

The mortgage market, including the market for prime and Alt-A loans, has been severely affected by changes in the lending landscape and there is no assurance that these conditions have stabilized or that they will not worsen. The severity of the liquidity limitation was largely unanticipated by the markets. For now (and for the foreseeable future), access to mortgages has been

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

substantially limited. While the limitation on financing was initially in the sub-prime mortgage market, the liquidity issues have now also affected prime and Alt-A non-Agency lending, with mortgage rates remaining much higher than previously available in recent periods and many product types being severely curtailed. This has an impact on new demand for homes, which will compress the home ownership rates and weigh heavily on future home price performance. There is a strong correlation between home price growth rates and mortgage loan delinquencies. The market deterioration has caused us to expect increased losses related to our holdings and to sell assets at a loss.

For the quarter ended June 30, 2008, we had no impairments on RMBS or whole mortgage loans. However, declines in the market values of our investments may adversely affect periodic reported results and credit availability, which may reduce earnings and, in turn, cash available for distribution to our stockholders.

41

A substantial portion of our assets are classified for accounting purposes as "available-for-sale" and carried at fair value. Changes in the market values of those assets are directly charged or credited to other comprehensive income. As a result, a decline in values may reduce the book value of our assets. Moreover, if the decline in value of an available-for-sale security is other than temporary, such decline will reduce earnings.

All of our repurchase agreements and interest rate swaps are subject to bilateral margin calls in the event that the collateral securing our obligations under those facilities exceeds or does not meet our collateralization requirements. We analyze the sufficiency of our collateralization daily, and as of June 30, 2008, on a net basis, the fair value of the collateral, including restricted cash, securing our obligations under repurchase agreements and interest rate swaps, exceeded the amount of such obligations by approximately \$71.8 million. During the six months ended June 30, 2008, due to the deterioration in the market value of our assets, we received margin calls under our repurchase agreements, which resulted in our having to obtain additional funding from third parties, including from Annaly, and take other steps to increase our liquidity. Additionally, the disruptions during the six months ended June 30, 2008 resulted in us not being in compliance with the net income covenant in one of our whole loan repurchase agreements and the liquidity covenants in our other whole loan repurchase agreement at a time during which we had no amounts outstanding under those facilities. We amended these covenants, and subsequent to June 30, 2008, we terminated those facilities in order to avoid paying non-usage fees. If we were unable to post additional collateral, we would have to sell the assets at a time when we might not otherwise choose to do so and such sales may be at a loss. A reduction in credit available may reduce our earnings and, in turn, cash available to us for distribution to stockholders.

In addition, we rely on the availability of financing to acquire residential mortgage loans, real estate-related securities and real estate loans on a leveraged basis. Institutions from which we will seek to obtain financing may have owned or financed residential mortgage loans, real estate-related securities and real estate loans which have declined in value and caused them to suffer losses as a result of the recent downturn in the residential mortgage market. If these conditions persist, these institutions may become insolvent or tighten their lending standards, which could make it more difficult for us to obtain financing on favorable terms or at all. Our profitability may be adversely affected if we were unable to obtain cost-effective financing for our investments.

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

A SIGNIFICANT PORTION OF OUR FINANCING IS FROM ONE LENDER.

Our ability to fund our investments on a leveraged basis depends to a large extent upon our ability to secure warehouse, repurchase, credit, and/or commercial paper financing on acceptable terms. The current dislocation in the non-Agency mortgage sector has made it difficult for us to obtain short-term financing on favorable terms. As a result, we have completed loan securitizations in order to obtain long-term financing and terminated our un-utilized whole loan repurchase agreements in order to avoid paying non-usage fees under those agreements. In addition, we have entered into a RMBS repurchase agreement with Annaly. This agreement contains customary representations, warranties and covenants contained in such agreements. As of June 30, 2008, we had \$50 million outstanding under the repurchase agreement. As of August 6, 2008, we had \$606 million outstanding under this agreement, which constitutes approximately 48% of our total financing. We cannot assure you that Annaly will continue to provide us with such financing. If Annaly does not provide us with financing, we cannot assure you that we will be able to replace such financing, and if we are not able to replace this financing, we could be forced to sell our assets at an inopportune time when prices are depressed.

OUR INVESTMENTS IN SUBORDINATED RMBS ARE GENERALLY IN THE "FIRST LOSS" POSITION AND OUR INVESTMENTS IN THE MEZZANINE RMBS ARE GENERALLY IN THE "SECOND LOSS" POSITION AND THEREFORE SUBJECT TO LOSSES.

In general, losses on a mortgage loan included in a securitization will be borne first by the equity holder of the issuing trust, and then by the "first loss" subordinated security holder and then by the "second loss" mezzanine holder. In the event of default and the exhaustion of any classes of securities junior to those in which we invest and there is any further loss, we will not be able to recover all of our investment in the securities we purchase. In addition, if the underlying mortgage portfolio has been overvalued by the originator, or if the values subsequently decline and, as a result, less collateral is available to satisfy interest and principal payments due on the related RMBS, the securities in which we invest may effectively become the "first loss" position behind the more senior securities, which may result in significant losses to us. The prices of lower credit quality securities are generally less sensitive to interest rate changes than more highly rated investments, but more sensitive to adverse economic downturns or individual issuer developments. A projection of an economic downturn, for example, could cause a decline in the price of lower credit quality securities because the ability of obligors of mortgages underlying RMBS to make principal and interest payments may be impaired. In such event, existing credit support in the securitization structure may be insufficient to protect us against loss of our principal on these securities.

42

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

- (a) The annual meeting of stockholders of Chimera Investment Corporation was held on May 20, 2008.
- (b) All Class I director nominees were elected.

| Director | Votes For | Votes Withheld |
|----------------------|------------|----------------|
| ----- Mark Abrams | 33,365,297 | 241,808 |

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

Paul Donlin

33,363,326

243,779

The continuing directors of the Company are Paul A. Keenan, Matthew Lambiase and Jeremy Diamond.

- (c) In addition to the election of the Class I directors, the ratification of the appointment of Deloitte & Touche LLP as our independent registered public accounting firm for 2008 was approved.

| | Votes Cast | | |
|---|------------|---------|---------|
| | For | Against | Abstain |
| Ratification of the appointment of independent registered public accounting firm for 2008 | 33,481,188 | 88,288 | 37,629 |

43

Item 6. EXHIBITS

Exhibits:

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

EXHIBIT INDEX

| Exhibit Number | Description |
|----------------|---|
| 3.1 | Articles of Amendment and Restatement of Chimera Investment Corporation (filed as Exhibit 3.1 to the Company's Registration Statement on Amendment No. 1 to Form S-11 (File No. 333-145525) filed on September 27, 2007 and incorporated herein by reference) |
| 3.2 | Amended and Restated Bylaws of Chimera Investment Corporation (filed as Exhibit 3.2 to the Company's Registration Statement on Amendment No. 2 to Form S-11 (File No. 333-145525) filed on November 5, 2007 and incorporated herein by reference) |
| 4.1 | Specimen Common Stock Certificate of Chimera Investment Corporation (filed as Exhibit 4.1 to the Company's Registration Statement on Amendment No. 1 to Form S-11 (File No. 333-145525) filed on September 27, 2007 and incorporated herein by reference) |
| 10.1 | Form of Management Agreement between Chimera Investment Corporation and Fixed Income Discount Advisory Company (filed as Exhibit 10.1 to the Company's Registration Statement on Amendment No. 1 to Form S-11 (File No. 333-145525) filed on September 27, 2007 and incorporated herein by reference) |
| 10.2+ | Form of Equity Incentive Plan (filed as Exhibit 10.2 to the Company's Registration Statement on Amendment No. 1 to Form S-11 (File No. 333-145525) filed on September 27, 2007 and incorporated herein by reference) |
| 10.3+ | Form of Restricted Common Stock Award (filed as Exhibit 10.3 |

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

- to the Company's Registration Statement on Amendment No. 1 to Form S-11 (File No. 333-145525) filed on September 27, 2007 and incorporated herein by reference)
- 10.4+ Form of Stock Option Grant (filed as Exhibit 10.4 to the Company's Registration Statement on Amendment No. 1 to Form S-11 (File No. 333-145525) filed on September 27, 2007 and incorporated herein by reference)
- 10.5 Form of Master Securities Repurchase Agreement (filed as Exhibit 10.5 to the Company's Registration Statement on Amendment No. 3 to Form S-11 (File No. 333-145525) filed on November 13, 2007 and incorporated herein by reference)
- 31.1 Certification of Matthew Lambiase, Chief Executive Officer and President of the Registrant, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of A. Alexandra Denahan, Chief Financial Officer of the Registrant, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Matthew Lambiase, Chief Executive Officer and President of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of A. Alexandra Denahan, Chief Financial Officer of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- + Represents a management contract or compensatory plan or arrangement.

44

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the city of New York, State of New York.

CHIMERA INVESTMENT CORPORATION

By: /s/ Matthew Lambiase

Matthew Lambiase
Chief Executive Officer and President
August 8, 2008

By: /s/ A. Alexandra Denahan

A. Alexandra Denahan
Chief Financial Officer (Principal Financial Officer)
August 8, 2008

45