ANNALY CAPITAL MANAGEMENT INC
Form 10-Q
May 07, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED: MARCH 31, 2009

OR

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

FOR THE TRANSITION PERIOD FROM _______________ TO _________________

COMMISSION FILE NUMBER: 1-13447

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

MARYLAND	22-3479661
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identificat

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

10036
(Zip Code)

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

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

Yes X No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes __ No __

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

Large accelerated filer |X| Accelerated filer |_| Non-accelerated filer |_| Smaller reporting com

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

Class	Outstanding at May 7, 2009
Common Stock, $.01 par value	544,344,030

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

FORM 10-Q

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Part I
Item 1. Financial Statements

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
MARCH 31, 2009 AND DECEMBER 31, 2008
(dollars in thousands, except for share data)

	March 31, 2009 (Unaudited)	Decemb
ASSETS		
Cash and cash equivalents	$1,035,118	
Reverse repurchase agreements with affiliate	452,480	
Mortgage-Backed Securities, at fair value	58,785,456	
Agency debentures, at fair value	-	
Available for sale equity securities, at fair value	51,418	
Receivable for Investment Securities sold	33,009	
Accrued interest and dividends receivable	291,347	
Receivable from Prime Broker	16,886	
Receivable for advisory and service fees	6,507	
Intangible for customer relationships, net	11,399	
Goodwill	27,917	
Other assets	5,717	
Total assets	$60,717,254	
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Repurchase agreements	$48,951,178	
Payable for Investment Securities purchased	2,121,670	
Accrued interest payable	112,457	
Dividends payable	272,170	
Accounts payable and other liabilities	23,970	
Interest rate swaps, at fair value	1,012,574	
Total liabilities	52,494,019	
6.00% Series B Cumulative Convertible Preferred Stock: 4,600,000 shares authorized 2,607,564 and 3,963,525 shares issued and outstanding respectively.	63,185	

Commitments and contingencies (Note 13)	-
Stockholders' Equity:	
7.875% Series A Cumulative Redeemable Preferred Stock: 7,412,500 shares authorized, issued and outstanding	177,088
Common stock: par value $.01 per share; 987,987,500 shares authorized, 544,339,785 and 541,475,366 issued and outstanding, respectively	5,443
Additional paid-in capital	7,667,769
Accumulated other comprehensive income	1,121,551
Accumulated deficit	(811,801)
Total stockholders' equity	8,160,050
Total liabilities, Series B Cumulative Convertible Preferred Stock and stockholders' equity	$60,717,254

(1) Derived from the audited consolidated statement of financial condition at December 31, 2008.

See notes to consolidated financial statements.

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ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
QUARTERS ENDED MARCH 31, 2009 AND 2008
(dollars in thousands, except per share amounts)
(Unaudited)

	For the Quarter Ended March 31, 2009	Fo
Interest income	$716,015	
Interest expense	378,625	
Net interest income	337,390	
Other income:		
Investment advisory and service fees	7,761	
Gain on sale of Investment Securities	5,023	
Income from trading securities	-	
Dividend income from available-for-sale equity securities	918	
Unrealized gain on interest rate swaps	35,545	
Total other income	49,247	
Expenses:		
Distribution fees	428	
General and administrative expenses	29,882	

Total expenses	30,310
	356,327
Income before income taxes and noncontrolling interest	
Income taxes	6,434
Net income	349,893
Noncontrolling interest	-
Net income attributable to controlling interest	349,893
Dividends on preferred stock	4,626
Net income available to common shareholders	$345,267
Net income available per share to common shareholders:	
Basic	$0.64
Diluted	$0.63
Weighted average number of common shares outstanding:	
Basic	542,903,110
Diluted	548,551,328
Net income attributable to controlling interest	$349,893
Other comprehensive gain (loss):	
Unrealized gain on available-for-sale securities	820,178
Unrealized gain (loss) on interest rate swaps	54,166
Reclassification adjustment for net gains included in net income	(5,023)
Other comprehensive income (loss)	869,321
Comprehensive income attributable to controlling interest	$1,219,214

See notes to consolidated financial statements.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
QUARTER ENDED MARCH 31, 2009
(dollars in thousands, except per share data)
(Unaudited)

		Accum
Common	Additional	Ot

	Preferred Stock	Stock Par Value	Paid-In Capital	Compr Incom
BALANCE, DECEMBER 31, 2008	$177,088	$5,415	$7,633,438	
Net income attributable to controlling interest	-	-	-	
Other comprehensive income	-	-	-	
Exercise of stock options and stock grants	-	-	623	
Stock option expense and long-term compensation expense	-	-	879	
Conversion of Series B cumulative convertible Preferred Stock	-	28	32,829	
Preferred Series A dividends declared $0.492188 per share	-	-	-	
Preferred Series B dividends declared $0.375 per share	-	-	-	
Common dividends declared, $0.50 per share	-	-	-	
BALANCE, MARCH 31, 2009	$177,088	$5,443	$7,667,769	$1

See notes to consolidated financial statements

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
QUARTERS ENDED MARCH 31, 2009 AND 2008
(dollars in thousands)
(Unaudited)

	For the Quarter Ended March 31, 2
Cash flows from operating activities:	
Net income	$349,
Adjustments to reconcile net income to net cash provided by operating activities:	
Net income attributable to noncontrolling interest	
Amortization of Mortgage Backed Securities premiums and discounts, net	41,
Amortization of intangibles	1,
Amortization of trading securities premiums and discounts	
Gain on sale of Investment Securities	(5,
Stock option and long-term compensation expense	
Unrealized gain on interest rate swaps	(35,
Net realized gain on trading investments	
Unrealized depreciation on trading investments	
Increase in accrued interest receivable	(8,
Decrease in trading sales receivables	
Decrease in other assets	
Purchase of trading securities	
Proceeds from sale of trading securities	
Purchase of trading securities sold, not yet purchased	
Proceeds from securities sold, not yet purchased	
Increase in advisory and service fees receivable	(
Decrease in interest payable	(87,
Increase (decrease) in accrued expenses and other liabilities	15,
Proceeds from repurchase agreements on from broker dealer	1,086,
Payments on repurchase agreements, broker dealer	(200,
Net cash provided by operating activities	1,157,
Cash flows from investing activities:	

Purchase of Mortgage-Backed Securities	(6,244,
Proceeds from sale of Investment Securities	882,
Principal payments of Mortgage-Backed Securities	2,502,
Agency debentures called	602,
Purchase of agency debentures	
Purchase of equity securities	
Purchase of reverse repurchase agreements	
Payments on reverse repurchase Agreements	109,
Net cash used in investing activities	(2,147,
Cash flows from financing activities:	
Proceeds from repurchase agreements	89,786,
Principal payments on repurchase agreements	(88,396,
Proceeds from exercise of stock options	
Proceeds from direct purchase and dividend reinvestment	
Net proceeds from follow-on offerings	
Net proceeds from ATM programs	
Noncontrolling interest	
Dividends paid	(275,
Net cash provided by financing activities	1,115,
Net increase in cash and cash equivalents	125,
Cash and cash equivalents, beginning of period	909,
Cash and cash equivalents, end of period	$1,035,
Supplemental disclosure of cash flow information:	
Interest paid	$466,
Taxes paid	$8,
Noncash financing activities:	
Net change in unrealized gain (loss) on available-for-sale securities and interest rate swaps, net of reclassification adjustment	$869,
Dividends declared, not yet paid	$272,
Noncash investing activities:	
Receivable for Investment Securities Sold	$33,
Payable for Investment Securities Purchased	$2,121,

See notes to consolidated financial statements.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE QUARTERS ENDED MARCH 31, 2009 AND 2008

1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Annaly Capital Management, Inc. ("Annaly" or the "Company") was incorporated in Maryland on November 25, 1996. The Company commenced its operations of purchasing and managing an investment portfolio of mortgage-backed securities on February 18, 1997, upon receipt of the net proceeds from the private placement of equity capital, and completed its initial public offering on October 14, 1997. The Company is a real estate investment trust ("REIT") under the Internal Revenue Code of 1986, as amended. Fixed Income Discount Advisory Company ("FIDAC") is a registered investment advisor and is a wholly owned taxable REIT subsidiary of the Company. During the third quarter of 2008, the Company formed RCap Securities, Inc. ("RCap"). RCap was granted membership in the Financial Industry Regulatory Authority ("FINRA") on January 26, 2009, and operates as broker-dealer. RCap is a wholly owned taxable REIT subsidiary of the Company. On October 31, 2008, the Company acquired Merganser Capital Management, Inc. ("Merganser"). Merganser is a registered investment advisor and is a wholly owned taxable REIT subsidiary of the Company.

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 may not include all of the information and footnotes required by accounting principles generally accepted in the United States of America ("GAAP").

The consolidated interim financial statements are unaudited; however, in the opinion of the Company's management, all adjustments, consisting only of normal recurring accruals, necessary for a fair statement of the financial positions, results of operations, and cash flows have been included. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2008. The nature of the Company's business is such that the results of any interim period are not necessarily indicative of results for a full year. The consolidated financial statements include the accounts of the Company, FIDAC, Merganser, RCap and an affiliated investment fund (the "Fund") which was a wholly owned subsidiary of the Company. All intercompany balances and transactions have been eliminated. The minority shareholder's interest in the earnings of the Fund is reflected as minority interest in the consolidated financial statements.

Cash and Cash Equivalents - Cash and cash equivalents include cash on hand and cash held in money market funds on an overnight basis.

Reverse Repurchase Agreements - The Company may invest its daily available cash balances via reverse repurchase agreements to provide additional yield on its assets. These investments will typically be recorded as short term investments and will generally mature daily. Reverse repurchase agreements are recorded at cost and are collateralized by mortgage-backed securities pledged by the counterparty to the agreement. Reverse repurchase agreements entered into by RCap are part of the subsidiary's daily matched book trading activity. These reverse repurchase agreements are recorded on trade date at the contract amount, are collateralized by mortgage backed securities and generally mature within 30 days. Margin calls are made by RCap as appropriate based on the daily valuation of the underlying collateral versus the contract price. RCap generates income from the spread between what is earned on the reverse repurchase agreements and what is paid on the matched repurchase agreements. Cash flows related to RCap's matchbook activity are included in cash flows from operating activity.

Mortgage-Backed Securities and Agency Debentures - The Company invests primarily in mortgage pass-through certificates, collateralized mortgage obligations and other mortgage-backed securities representing interests in or obligations backed by pools of mortgage loans, and certificates guaranteed by the Government National Mortgage Association ("Ginnie Mae"), the Federal Home Loan Mortgage Corporation ("Freddie Mac"), and the Federal National Mortgage Association ("Fannie Mae") (collectively, "Mortgage-Backed Securities"). The

Company also invests in agency debentures issued by Federal Home Loan Bank ("FHLB"), Freddie Mac and Fannie Mae. The Mortgage-Backed Securities and agency debentures are collectively referred to herein as "Investment Securities."

Statement of Financial Accounting Standards ("SFAS") No. 115, Accounting for Certain Investments in Debt and Equity Securities ("SFAS 115"), requires the Company to classify its Investment Securities as either trading investments, available-for-sale investments or held-to-maturity investments. Although the Company generally intends to hold most of its Investment Securities until maturity, it may, from time to time, sell any of its Investment Securities as part of its overall management of its portfolio. Accordingly, the Company classifies all of its Investment Securities as available-for-sale. All assets classified as available-for-sale are reported at estimated fair value, based on market prices from independent sources, with unrealized gains and losses excluded from earnings and reported as a separate component of stockholders' equity. The Company's investment in Chimera Investment Corporation ("Chimera") is accounted for as available-for-sale equity securities under the provisions of SFAS 115.

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Based on the guidance provided by Financial Accounting Standards Board ("FASB"), the FASB issued FSP FAS 115-2 and FSP FAS 124-2, Recognition and Presentation of Other Than Temporary Impairments. FSP FAS 115-2 and FSP FAS 124-2 are effective for interim and annual periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009 and the Company decided to early adopt these two FSPs. Under these FSPs, the Company determines if it has (1) the intent to sell the Investment Securities, (2) it is more likely than not that it will be required to sell the securities before recovery, or (3) it does not expect to recover the entire amortized cost basis of the Investment Securities. Further, the security is analyzed for credit loss (the difference between the present value of cash flows expected to be collected and the amortized cost basis). The credit loss, if any, will then be recognized in the statement of earnings, while the balance of impairment related to other factors will be recognized in other comprehensive income ("OCI"). For the quarters ended March 31, 2009 and 2008, the Company did not have unrealized losses on Investment Securities that were deemed other than temporary.

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, available-for-sale equity securities, trading securities, trading securities sold, not yet purchased, receivable from prime broker and interest rate swaps is equal to their carrying value presented in the consolidated statements of financial condition. Cash and cash equivalents, reverse repurchase agreements, accrued interest and dividends receivable, receivable for securities sold, receivable for advisory and service fees, repurchase agreements with maturities shorter than one year, payable for Investment Securities purchased, dividends payable, accounts payable and other liabilities, and accrued interest payable, generally approximates fair value as of March 31, 2009 due to the short term nature of these financial instruments. The estimated fair value of long term structured repurchase agreements is reflected in the Footnote 7 to the financial statements.

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

Investment Securities transactions are recorded on the trade date. Purchases of newly-issued securities are recorded when all significant uncertainties regarding the characteristics of the securities are removed, generally shortly before settlement date. Realized gains and losses on sales of Investment Securities are determined on the specific identification method.

Derivative Financial Instruments/Hedging Activity - Prior to the fourth quarter of 2008, the Company designated interest rate swaps as cash flow hedges, whereby the swaps were recorded at fair value on the balance sheet as assets and liabilities with any changes in fair value recorded in OCI. In a cash flow hedge, a swap would exactly match the pricing date of the relevant repurchase agreement. Through the end of the third quarter of 2008 the Company continued to be able to effectively match the swaps with the repurchase agreements therefore entering into effective hedge transactions. However, due to the volatility of the credit markets, it is no longer practical to match the pricing dates of both the swaps and the repurchase agreements.

As a result, the Company voluntarily discontinued hedge accounting after the third quarter of 2008 through a combination of de-designating previously defined hedge relationships and not designating new contracts as cash flow hedges. The de-designation of cash flow hedges was done in accordance with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and Derivatives Implementation Group "DIG" Issue Nos. G3, G17, G18 & G20, which generally requires that the net derivative gain or loss related to the discontinued cash flow hedge should continue to be reported in accumulated OCI, unless it is probable that the forecasted transaction will not occur by the end of the originally specified time period or within an additional two-month period of time thereafter. The Company continues to hold repurchase agreements in excess of swap contracts and has no indication that interest payments on the hedged repurchase agreements are in jeopardy of discontinuing. Therefore, the deferred losses related to these derivatives that have been de-designated will not be recognized immediately and will remain in OCI. These losses are reclassified into earnings during the contractual terms of the swap agreements starting as of October 1, 2008. Changes in the unrealized gains or losses on the interest rate swaps subsequent to September 30, 2008 are reflected in the Company's statement of operations.

Credit Risk - The Company has limited its exposure to credit losses on its portfolio of Investment Securities by only purchasing securities issued by Freddie Mac, Fannie Mae, or Ginnie Mae and agency debentures issued by the FHLB, Freddie Mac and Fannie Mae. The payment of principal and interest on the Freddie Mac, and Fannie Mae Mortgage-Backed Securities are guaranteed by those respective agencies, and the payment of principal and interest on the Ginnie Mae Mortgage-Backed Securities are backed by the full faith and credit of the U.S. government. Principal and interest on agency debentures are guaranteed by the agency issuing the debenture. All of the Company's Investment Securities have an actual or implied "AAA" rating. The Company faces credit risk on the portions of its portfolio which are not Investment Securities.

Market Risk - The current situation in the mortgage sector and the current weakness in the broader mortgage market could adversely affect one or more of the Company's lenders and could cause one or more of the Company's lenders to be unwilling or unable to provide additional financing. This could potentially increase the Company's financing costs and reduce liquidity. If one or more major market participants fails, it could negatively impact the marketability of all fixed income securities, including agency mortgage securities. 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 additional financing, the Company could be forced to sell its Investment Securities at an inopportune time when prices are depressed. Even with the current situation in the mortgage sector, the Company does not anticipate having difficulty converting its assets to cash or extending financing terms due to the fact that its Investment Securities have an actual or implied "AAA" rating and principal payment is guaranteed by Freddie Mac, Fannie Mae, or Ginnie Mae.

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

Repurchase Agreements - The Company finances the acquisition of its Investment Securities through the use of repurchase agreements. Repurchase agreements are treated as collateralized financing transactions and are carried at their contractual amounts, including accrued interest, as specified in the respective agreements. Repurchase agreements entered into by RCap are matched with specific reverse repurchase agreements and are recorded on trade date with the duration of such repurchase agreements mirroring those of the matched reverse repurchase agreements. The repurchase agreements are recorded at the contract amount and margin calls are filled by RCap as required based on any deficiencies in collateral versus the contract price. RCap generates income from the spread between what is earned on the reverse repurchase agreements and what is paid on the repurchase agreements. Intercompany transactions are eliminated in the statement of financial condition, statement of operations, and statement of cash flows. Cash flows related to RCap's repurchase agreements are included in cash flows from operating activity.

Cumulative Convertible Preferred Stock- The Company classifies its Series B Cumulative Convertible Preferred Stock ("Series B Preferred Stock") on the consolidated statements of financial condition using the guidance in SEC Accounting Series Release No. 268, Presentation in Financial Statements of "Redeemable Preferred Stocks," and Emerging Issues Task Force ("EITF") Topic

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D-98, Classification and Measurement of Redeemable Securities. The Series B Preferred Stock contains fundamental change provisions that allow the holder to redeem the Series B Preferred Stock for cash if certain events occur. As redemption under these provisions is not solely within the Company's control, the Company has classified the Series B Preferred Stock as temporary equity in the accompanying consolidated statements of financial condition.

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

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

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

Goodwill and Intangible assets - The Company's acquisitions of FIDAC and Merganser were accounted for using the purchase method. Under the purchase method, net assets and results of operations of acquired companies are included in the consolidated financial statements from the date of acquisition. In addition, the costs of FIDAC and Merganser were allocated to the assets acquired, including identifiable intangible assets, and the liabilities assumed based on their estimated fair values at the date of acquisition. The excess of purchase price over the fair value of the net assets acquired was recognized as goodwill. Intangible assets are periodically (but not less frequently than annually) reviewed for potential impairment. Intangible assets with an estimated useful life are expected to amortize over a 10.8 year weighted average time period. During the quarters ended March 31, 2009 and 2008, there were no impairment losses.

Stock Based Compensation - The Company accounts for its stock-based compensation in accordance with SFAS No. 123 (Revised 2004) - Share-Based Payment ("SFAS 123R"). SFAS 123R requires the Company to measure and recognize in the consolidated financial statements the compensation cost relating to share-based payment transactions. The compensation cost should be reassessed based on the fair value of the equity instruments issued.

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

Fair Value Measurement - In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value and requires enhanced disclosures about fair value measurements. SFAS 157 requires companies to disclose the fair value of 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 (the valuation of which require significant management judgment), including a reconciliation of the beginning and ending balances separately for each major category of assets and liabilities. SFAS 157 was adopted by the Company on January 1, 2008. SFAS 157 did not have an impact on the manner in which the Company estimates fair value, but it requires additional disclosure, which is included in Note 6.

Recent Accounting Pronouncements - In February 2008, FASB issued FASB Staff Position No. FAS 140-3 Accounting for Transfers of Financial Assets and Repurchase Financing Transactions ("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

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 are readily obtainable in the market; and (4) the financial instrument and the repurchase agreement are not coterminous. This FSP was effective for the Company on January 1, 2009. The implementation of this FSP did not have a material effect on the financial statements of the Company.

On January 1, 2009, the Company adopted SFAS 160, Noncontrolling Interests in Consolidated Financial Statements, an Amendment of ARB No. 51, which requires the Company to make certain changes to the presentation of its financial statements. This standard requires us to classify noncontrolling interests (previously referred to as "minority interest") as part of consolidated net income and to include the accumulated amount of noncontrolling interests as part of stockholders' equity. Similarly, in its presentation of stockholders' equity, the Company distinguishes between equity amounts attributable to controlling interest and amounts attributable to the noncontrolling interests - previously classified as minority interest outside of stockholders' equity. For the quarter ended March 31, 2009 and year-ended December 31, 2008 the Company do not have any noncontrolling interest. In addition to these financial reporting changes, SFAS 160 provides for significant changes in accounting related to noncontrolling interests; specifically, increases and decreases in its controlling financial interests in consolidated subsidiaries will be reported in equity similar to treasury stock transactions. If a change in ownership of a consolidated subsidiary results in loss of control and deconsolidation, any retained ownership interests are remeasured with the gain or loss reported in net earnings. Since the first quarter of 2008, the Company did not have any noncontrolling interest in any of its subsidiaries. However, the retrospective effect of the presentation and disclosure requirement under SFAS 160 will be applied.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations, ("SFAS 141R") which replaces SFAS No. 141, Business Combinations. SFAS 141R establishes principles and requirements for recognizing and measuring identifiable assets and goodwill acquired, liabilities assumed and any noncontrolling interest in a business combination at their fair value at acquisition date. SFAS 141R alters the treatment of acquisition-related costs, business combinations achieved in stages (referred to as a step acquisition), the treatment of gains from a bargain purchase, the recognition of contingencies in business combinations, the treatment of in-process research and development in a business combination as well as the treatment of recognizable deferred tax benefits. SFAS 141R is effective for business combinations closed in fiscal years beginning after December 15, 2008. As SFAS 141R is applicable to business acquisitions completed after January 1, 2009 and the Company did not make any business acquisitions during the quarter ended March 31, 2009 the adoption of SFAS 141R did not have a material impact on the Company's consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161 ("SFAS 161"), Disclosures about Derivative Instruments and Hedging Activities, and an amendment of FASB Statement No. 133. SFAS 161 attempts to improve the transparency of financial reporting by mandating the provision of 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 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 mandates, SFAS 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts, 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 was effective for the Company as of January 1, 2009 and was adopted prospectively. The Company discontinued hedge accounting as of September 30, 2008, and therefore the effect of the adoption of SFAS 161 will be a minimal increase in footnote disclosures. A table of the effect of the de-designated swap transactions will be included to indicate the effect on OCI and Other Income (Expense) in footnote 8.

On October 10, 2008, FASB issued FASB Staff Position (FSP) 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active ("FSP 157-3"), in response to the deterioration of the credit markets. This FSP provides guidance clarifying how SFAS 157 should be applied when valuing securities in markets that are not active. The guidance provides an illustrative example that applies the objectives and framework of SFAS 157,

utilizing management's internal cash flow and discount rate assumptions when relevant observable data does not exist. It further clarifies how observable market information and market quotes should be considered when measuring fair value in an inactive market. It reaffirms the notion of fair value as an exit price as of the measurement date and that fair value analysis is a transactional process and should not be broadly applied to a group of assets. FSP 157-3 was effective upon issuance including prior periods for which financial statements have not been issued. FSP 157-3 did not have a material effect on the fair value of its assets as the Company intends to continue to hold assets that can be valued via level 1 and level 2 criteria, as defined under SFAS 157.

On October 3, 2008 the Emergency Economic Stabilization Act of 2008 (the EESA) was signed into law. Section 133 of the EESA mandated that the Securities and Exchange Commission (SEC) conduct a study on mark-to-market accounting standards. The SEC provided its study to the US Congress on December 30, 2008. Part of the recommendations within the study indicated that "fair value requirements should be improved through development of application and best practices guidance for determining fair value in illiquid or inactive markets." As a result of this study and the recommendations therein, the FASB issued Staff Position (FSP) FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly. This FSP provides additional guidance on determining fair value when the volume and level of activity for the asset or liability have significantly decreased when compared with normal market activity for the asset or liability (or similar assets or liabilities). The FSP gives specific factors to evaluate if there has been a decrease in normal market activity and if so, provides a methodology to analyze transactions or quoted prices and make necessary adjustments to fair value in accordance with Statement 157. The objective is to determine the point within a range of fair value estimates that is most representative of fair value under current market conditions. FSP FAS157-4 is effective for interim and annual reporting periods ending after June 15, 2009 with early adoption permitted for periods ending after March 15, 2009 and the Company decided to early adopt FSP FAS 157-4. The implementation of FSP FAS157-4 has no major impact on the manner in which the Company estimates fair value, nor does it have any impact on current disclosure.

Additionally, in conjunction with FSP 157-4, the FASB issued FAS 115-2 and FAS 124-2, Recognition and Presentation of Other Than Temporary Impairments. The objective of the new guidance is to make impairment guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments (OTTI) on debt and equity securities in financial statements. This guidance was also the result of the SEC mark-to-market study mandated under the EESA. The SEC's recommendation was to "evaluate the need for modifications (or the elimination) of current OTTI guidance to provide for a more uniform system of impairment testing standards for financial instruments". The guidance revises the OTTI evaluation methodology. Previously the analytical focus was on whether the company had the "intent and ability to retain its investment in the debt security for a period of time sufficient to allow for any anticipated recovery in fair value". Now the focus is on whether the Company has the (1) the intent to sell the Investment Securities, (2) it is more likely than not that it will be required to sell the Investment Securities before recovery, or (3) it does not expect to recover the entire amortized cost basis of the Investment Securities. Further, the security is analyzed for credit loss, (the difference between the present value of cash flows expected to be collected and the amortized cost basis). The credit loss, if any, will then be recognized in the statement of earnings, while the balance of impairment related to other factors will be recognized in OCI. FAS 115-2 and FAS 124-2 are effective for all interim and annual periods ending after June 15, 2009 with early adoption permitted for periods ending after March 15, 2009 and the Company decided to early adopt FSP FAS 115-2 and FSP FAS 124-2. For the quarter ended March 31, 2009, the Company did not have unrealized losses in Investment Securities that were deemed other-than-temporary.

On April 9, 2009, the FASB also issued FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments. The rule/guideline requires disclosures about fair value of financial instruments for interim reporting periods as well as in annual financial statements. The effective date of this rule/guideline is for interim reporting periods ending after June 15, 2009 with early adoption permitted for periods ending after March 15, 2009. The Company's early adoption did not impact financial reporting as all financial instruments are currently reported at fair value in both interim and annual periods.

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2. MORTGAGE-BACKED SECURITIES

The following tables present the Company's available-for-sale Mortgage-Backed Securities portfolio as of March 31, 2009 and December 31, 2008 which were carried at their fair value:

March 31, 2009	Federal Home Loan Mortgage Corporation	Federal National Mortgage Association	Government Nation Mortgage Associat
		(dollars in thousands)	
Mortgage-Backed Securities, gross	$19,993,488	$34,891,680	$1,833,
Unamortized discount	(25,874)	(33,931)	(
Unamortized premium	226,636	451,497	50,
Amortized cost	$20,194,250	$35,309,246	$1,883,
Gross unrealized gains	544,835	921,016	33,
Gross unrealized losses	(36,893)	(63,515)	(
Estimated fair value	$20,702,192	$36,166,747	$1,916,

	Amortized Cost	Gross Unrealized Gain	Gross Unrealized L
		(dollars in thousands)	
Adjustable rate	$19,734,089	$336,690	($100,
Fixed rate	37,652,610	1,162,984	(
Total	$57,386,699	$1,499,674	($100,

December 31, 2008	Federal Home Loan Mortgage Corporation	Federal National Mortgage Association	Government Nation Mortgage Associat
		(dollars in thousands)	
Mortgage-Backed Securities, gross	$19,898,430	$32,749,123	$1,259,
Unamortized discount	(26,733)	(36,647)	(
Unamortized premium	212,354	381,433	25,
Amortized cost	20,084,051	33,093,909	1,284,
Gross unrealized gains	297,366	468,824	14,
Gross unrealized losses	(71,195)	(123,443)	(1,
Estimated fair value	$20,310,222	$33,439,290	$1,297,

	Amortized Cost	Gross Unrealized Gain	Gross Unrealized L
		(dollars in thousands)	
Adjustable rate	$19,509,017	$287,249	($178,
Fixed rate	34,952,968	493,547	(17,
Total	$54,461,985	$780,796	($195,

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Actual maturities of Mortgage-Backed Securities are generally shorter than stated contractual maturities because actual maturities of Mortgage-Backed Securities are affected by the contractual lives of the underlying mortgages, periodic payments of principal, and prepayments of principal. The following table summarizes the Company's Mortgage-Backed Securities on March 31, 2009 and December 31, 2008, according to their estimated weighted-average life classifications:

	March 31, 2009	Decem

Weighted-Average Life	Fair Value	Amortized Cost	Fair Va
		(dollars in thousands)	
Less than one year	$ 3,949,455	$ 3,915,546	$ 4,147,
Greater than one year and less than five years	41,960,853	40,859,762	37,494,
Greater than or equal to five years	12,875,148	12,611,391	13,405,
Total	$58,785,456	$57,386,699	$55,046,

The weighted-average lives of the Mortgage-Backed Securities at March 31, 2009 and December 31, 2008 in the table above are based upon data provided through subscription-based financial information services, assuming constant principal prepayment rates to the reset date of each security. The prepayment model considers current yield, forward yield, steepness of the yield curve, current mortgage rates, mortgage rate of the outstanding loans, loan age, margin and volatility. The actual weighted average lives of the Mortgage-Backed Securities could be longer or shorter than estimated.

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 March 31, 2009 and December 31, 2008.

	Unrealized Loss Position For: (dollars in thousands)				
	Less than 12 Months		12 Months or More		
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimate Val
March 31, 2009	$925,368	($8,691)	$4,559,464	($92,226)	$5,
December 31, 2008	$4,631,897	($65,790)	$4,267,448	($129,996)	$8,

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 does not have the intent to sell the Investment Securities and more likely than not, the Company will not be required to sell the Investment Securities before recovery of their amortized cost basis, which may be maturity. The Company does not consider these investments to be other-than-temporarily impaired at March 31, 2009. Also, the Company is guaranteed payment of the principal amount of the securities by the government agency which created them.

The adjustable rate Mortgage-Backed Securities are limited by periodic caps (generally interest rate adjustments are limited to no more than 1% every nine months) and lifetime caps. The weighted average lifetime cap was 10.1% at March 31, 2009 and 10.0% at December 31, 2008.

During the quarter ended March 31, 2009, the Company sold $835.7 million of

Mortgage-Backed Securities, resulting in a realized gain of $5.0 million. During the quarter ended March 31, 2008, the Company sold $4.1 billion of Mortgage-Backed Securities, resulting in a realized gain of $9.4 million.

3. AVAILABLE FOR SALE EQUITY SECURITIES

All of the available-for-sale equity securities are shares of Chimera and are reported at fair value. The Company owns approximately 15.3 million shares of Chimera at a fair value of $51.4 million at March 31, 2009 and $52.8 million at December 31, 2008. . At March 31, 2009 and December 31, 2008, the investment in Chimera had an unrealized gain of $2.6 million and $4.0 million, respectively.

4. REVERSE REPURCHASE AGREEMENT

At March 31, 2009 and December 31, 2008, the Company had lent $452.5 million and $562.1 million, respectively, to Chimera in an overnight reverse repurchase agreement. This amount is included at the principal amount which approximates fair value in the Company's Statement of Financial Condition. The interest rate at March 31, 2009 and December 31, 2008 was at the market rate of 2.01% and 1.43%, respectively. The collateral for this loan is mortgage-backed securities with a fair value of $532.1 million and $680.8 million at March 31, 2009 and December 31, 2008, respectively.

5. RECEIVABLE FROM PRIME BROKER

These net assets of the investment fund owned by the Company are subject to English bankruptcy law, which governs the administration of Lehman Brothers International (Europe) ("LBIE"), as well as the law of New York, which governs the contractual documents. Until the Company's contractual documents with LBIE are terminated, the value of the assets and liabilities in its account with LBIE will continue to fluctuate based on market movements. The Company does not intend to terminate these contractual documents until LBIE's administrators have clarified the consequences of doing so. The Company has not received notice from LBIE's administrators that LBIE has terminated the documents. LBIE's administrators have advised the Company that they can provide no additional information about the account at this time. As a result, the Company has recorded a receivable from LBIE based on the fair value of its account with LBIE as of September 15, 2008 of $16.9 million, which is the date of the last statement it received from LBIE on the account's assets and liabilities. The Company can provide no assurance, however, that it will recover all or any portion of these assets following completion of LBIE's administration (and any subsequent liquidation). Based on the information known at March 31, 2009, a loss was not determined to be probable. If additional information indicates otherwise and it is determined that the loss is probable, the estimated loss will be reflected in the statement of operations.

6. 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 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 overall fair value.

Available for sale equity securities are valued based on quoted prices (unadjusted) in an active market. Mortgage-Backed Securities and interest rate swaps are valued using quoted prices for similar assets and dealer quotes. The dealer 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 and expected life of the security. Management reviews all prices used to ensure that current market conditions are represented. This review includes comparisons of similar market transactions and comparisons to a pricing model. The Company's financial assets and liabilities carried at fair value on a recurring basis are valued as follows:

	Level 1	Level 2
		(dollars in thousand
Assets:		
Mortgage-Backed Securities	-	$58,785,456
Available for sale equity securities	$51,418	-
Liabilities:		
Interest rate swaps	-	$1,012,574

The classification of assets and liabilities by level remains unchanged at March 31, 2009, when compared to the previous quarter.

7. REPURCHASE AGREEMENTS

The Company had outstanding $49.0 billion and $46.7 billion of repurchase agreements with weighted average borrowing rates of 2.78% and 4.08%, after giving effect to the Company's interest rate swaps, and weighted average remaining maturities of 219 days and 238 days as of March 31, 2009 and December 31, 2008, respectively. Investment Securities pledged as collateral under these repurchase agreements and interest rate swaps had an estimated fair value of $55.1 billion at March 31, 2009 and $51.8 billion at December 31, 2008.

At March 31, 2009 and December 31, 2008, the repurchase agreements had the following remaining maturities:

	March 31, 2009	December 31, 2008
	(dollars in thousands)	
Within 30 days	$36,955,906	$32,025,186
30 to 59 days	2,815,272	5,205,352
60 to 89 days	-	209,673
90 to 119 days	-	254,674
Over 120 days	9,180,000	8,980,000
Total	$48,951,178	$46,674,885

The Company did not have an amount at risk greater than 10% of the equity of the Company with any counterparty as of March 31, 2009 or December 31, 2008.

The Company has entered into long- term repurchase agreements which provide the counterparty with the right to call the balance prior to maturity date. These repurchase agreements totaled $8.8 billion and the fair value of the option to call was ($489.1 million) at March 31, 2009. These repurchase agreements totaled $8.1 billion and the fair value of the option to call was ($574.3 million) at December 31, 2008. Management has determined that the call option is not required to be bifurcated under the provisions of SFAS 133 as it is deemed clearly and closely related to the debt instrument, therefore the fair value of the option is not recorded in the consolidated financial statements.

8. INTEREST RATE SWAPS

In connection with the Company's interest rate risk management strategy, the Company hedges a portion of its interest rate risk by entering into derivative financial instrument contracts. As of March 31, 2009, such instruments are comprised of interest rate swaps, which in effect modify the cash flows on repurchase agreements. The use of interest rate swaps creates exposure to credit risk relating to potential losses that could be recognized if the counterparties to these instruments fail to perform their obligations under the contracts. In the event of a default by the counterparty, the Company could have difficulty obtaining its Mortgage-Backed Securities pledged as collateral for swaps. The Company does not anticipate any defaults by its counterparties.

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

The location and fair value of derivative instruments reported in the Consolidated Statement of Financial Position as of March 31, 2009 are as follows:

	Location on Statement of Financial Condition	Notional Amount (dollars in thousands)	Weighted Average Pay Rate	Weighted Average Receive Rate	V
March 31, 2009	Liabilities	$17,339,850	4.55%	0.55%	

The effect of derivatives on the Statement of Operations and Comprehensive Income is as follows:

	Location on Statement of Operations and Compre	
	Interest Expense (dollars in thousands)	Unrealized Ra
For the Quarter Ended March 31, 2009	$200,738	

9. PREFERRED STOCK AND COMMON STOCK

(A) Common Stock Issuances

During the quarter ended March 31, 2009, 55,887 options were exercised, for an aggregate exercise price of $623,000 and 7,550 shares of restricted stock were issued under the Long-Term Stock Incentive Plan, or Incentive Plan. During the quarter ended March 31, 2009, 1,355,961 shares of Series B Preferred Stock were converted into 2,801,000 shares of common stock.

On May 13, 2008 the Company entered into an underwriting agreement pursuant to which it sold 69,000,000 shares of its common stock for net proceeds following underwriting expenses of approximately $1.1 billion. This transaction settled on May 19, 2008.

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

During the year ended December 31, 2008, the Company raised $93.7 million by issuing 5.8 million shares, through the Direct Purchase and Dividend Reinvestment Program.

During the year ended December 31, 2008, 300,000 options were exercised under the Long-Term Stock Incentive Plan, or Incentive Plan, for an aggregate exercise price of $2.8 million.

On August 3, 2006, the Company entered into an ATM Equity Offering(sm) Sales Agreement with Merrill Lynch & Co. and Merrill Lynch, Pierce, Fenner & Smith Incorporated, relating to the sale of shares of the Company's common stock from time to time through Merrill Lynch. Sales of the shares, if any, are made by means of ordinary brokers' transaction on the New York Stock Exchange. During the year ended December 31, 2008, 588,000 shares of the Company's common stock were issued pursuant to this program, totaling $11.5 million in net proceeds.

On August 3, 2006, the Company entered into an ATM Equity Sales Agreement with UBS Securities LLC, relating to the sale of shares of the Company's common stock from time to time through UBS Securities. Sales of the shares, if any, will be made by means of ordinary brokers' transaction on the New York Stock Exchange. During the year ended December 31, 2008, 3.8 million shares of the Company's common stock were issued pursuant to this program, totaling $60.3 million in net proceeds.

(B) Preferred Stock

At March 31, 2009 and December 31, 2008, the Company had issued and outstanding 7,412,500 shares of Series A Cumulative Redeemable Preferred Stock ("Series A Preferred Stock"), with a par value $0.01 per share and a liquidation preference of $25.00 per share plus accrued and unpaid dividends (whether or not declared). The Series A Preferred Stock must be paid a dividend at a rate of 7.875% per year on the $25.00 liquidation preference before the common stock is entitled to receive any dividends. The Series A Preferred Stock is redeemable at $25.00 per share plus accrued and unpaid dividends (whether or not declared) exclusively at the Company's option commencing on April 5, 2009 (subject to the Company's right under limited circumstances to redeem the Series A Preferred Stock earlier in order to preserve its qualification as a REIT). The Series A Preferred Stock is senior to the Company's common stock and is on parity with the Series B Preferred Stock with respect to dividends and distributions, including distributions upon liquidation, dissolution or winding up. The Series

A Preferred Stock generally does not have any voting rights, except if the Company fails to pay dividends on the Series A Preferred Stock for six or more quarterly periods (whether or not consecutive). Under such circumstances, the Series A Preferred Stock, together with the Series B Preferred Stock, will be entitled to vote to elect two additional directors to the Board, until all unpaid dividends have been paid or declared and set apart for payment. In addition, certain material and adverse changes to the terms of the Series A Preferred Stock cannot be made without the affirmative vote of holders of at least two-thirds of the outstanding shares of Series A Preferred Stock and Series B Preferred Stock. Through March 31, 2009, the Company had declared and paid all required quarterly dividends on the Series A Preferred Stock.

At March 31, 2009 and December 31, 2008, the Company had issued and outstanding 2,607,564 and 3,963,525 shares, respectively, of Series B Cumulative Convertible Preferred Stock ("Series B Preferred Stock"), with a par value $0.01 per share and a liquidation preference of $25.00 per share plus accrued and unpaid dividends (whether or not declared). The Series B Preferred Stock must be paid a dividend at a rate of 6% per year on the $25.00 liquidation preference before the common stock is entitled to receive any dividends. The Series B Preferred Stock is not redeemable. The Series B Preferred Stock is convertible into shares of common stock at a conversion rate that adjusts from time to time upon the occurrence of certain events, including if the Company distributes to its common shareholders in any calendar quarter cash dividends in excess of $0.11 per share. Initially, the conversion rate was 1.7730 shares of common shares per $25 liquidation preference. At March 31, 2009 and December 31, 2008, the conversion ratio was 2.1228 and 2.0650 shares of common stock, respectively, per $25 liquidation preference. Commencing April 5, 2011, the Company has the right in certain circumstances to convert each Series B Preferred Stock into a number of common shares based upon the then prevailing conversion rate. The Series B Preferred Stock is also convertible into common shares at the option of the Series B preferred shareholder at anytime at the then prevailing conversion rate. The Series B Preferred Stock is senior to the Company's common stock and is on parity with the Series A Preferred Stock with respect to dividends and distributions, including distributions upon liquidation, dissolution or winding up. The Series B Preferred Stock generally does not have any voting rights, except if the Company fails to pay dividends on the Series B Preferred Stock for six or more quarterly periods (whether or not consecutive). Under such circumstances, the Series B Preferred Stock, together with the Series A Preferred Stock, will be entitled to vote to elect two additional directors to the Board, until all unpaid dividends have been paid or declared and set apart for payment. In addition, certain material and adverse changes to the terms of the Series B Preferred Stock cannot be made without the affirmative vote of holders of at least two-thirds of the outstanding shares of Series B Preferred Stock and Series A Preferred Stock. Through March 31, 2009, the Company had declared and paid all required quarterly dividends on the Series B Preferred Stock. During the quarter ended March 31, 2009, 1,355,961 shares of Series B Preferred Stock were converted into 2,801,000 shares of common stock.

(C) Distributions to Shareholders

During the quarter ended March 31, 2009, the Company declared dividends to common shareholders totaling $272.2 million or $0.50 per share, which were paid to shareholders on April 29, 2009. During the quarter ended March 31, 2009, the Company declared dividends to Series A Preferred shareholders totaling approximately $3.6 million or $0.492188 per share, and Series B shareholders totaling approximately $978,000 or $0.375 per share, which were paid to shareholders on March 31, 2009.

10. NET INCOME PER COMMON SHARE

The following table presents a reconciliation of the net income and shares used in calculating basic and diluted earnings per share for the quarters ended March 31, 2009 and 2008.

	For the Quar
	March 31, 2009
Net income attributable to controlling interest	$349,893
Less: Preferred stock dividends	4,626
Net income available to common shareholders, prior to adjustment for Series B dividends, if necessary	$345,267
Add: Preferred Series B dividends, if Series B shares are dilutive	978
Net income available to common shareholders, as adjusted	$346,245
Weighted average shares of common stock outstanding-basic	542,903
Add: Effect of dilutive stock options and	113
Series B Cumulative Convertible Preferred Stock	5,535
Weighted average shares of common stock outstanding-diluted	548,551

Options to purchase 4.5 million and 5,000 shares of common stock were outstanding and considered anti-dilutive as their exercise price and option expense exceeded the average stock price for the quarters ended March 31, 2009 and 2008, respectively.

11. LONG-TERM STOCK INCENTIVE PLAN

The Company has adopted a long term stock incentive plan for executive officers, key employees and non-employee directors (the "Incentive Plan"). The Incentive Plan authorizes the Compensation Committee of the board of directors to grant awards, including non-qualified options as well as incentive stock options as defined under Section 422 of the Code. The Incentive Plan authorizes the granting of options or other awards for an aggregate of the greater of 500,000 shares or 9.5% of the diluted outstanding shares of the Company's common stock, up to ceiling of 8,932,921 shares. Stock options are issued at the current market price on the date of grant, subject to an immediate or four year vesting in four equal installments with a contractual term of 5 or 10 years. The grant date fair value is calculated using the Black-Scholes option valuation model.

For the Quarters Ended		
March 31, 2009		Marc
Number of Shares	Weighted Average Exercise Price	Number of Shares

Options outstanding at the beginning of quarter	5,180,164	$15.87	3,437,267
Granted	-	-	-
Exercised	(55,887)	11.17	(170,617
Forfeited	-	-	-
Expired	-	-	-
Options outstanding at the end of the quarter	5,124,277	$15.92	3,266,650
Options exercisable at the end of the quarter	2,241,702	$16.12	1,738,900

The weighted average remaining contractual term was approximately 7.3 years for stock options outstanding and approximately 5.5 years for stock options exercisable as of March 31, 2009. As of March 31, 2009, there was approximately $8.5 million of total unrecognized compensation cost related to nonvested share-based compensation awards. That cost is expected to be recognized over a weighted average period of 3.1 years.

The weighted average remaining contractual term was approximately 6.9 years for stock options outstanding and approximately 5.8 years for stock options exercisable as of March 31, 2008. As of March 31, 2008, there was approximately $2.3 million of total unrecognized compensation cost related to nonvested share-based compensation awards. That cost is expected to be recognized over a weighted average period of 2.5 years.

During the quarter ended March 31, 2009, the Company granted 7,550 shares of restricted common stock to certain of its employees. As of March 31, 2009, 5,663 of these restricted shares were unvested and subject to forfeiture. During the year ended December 31. 2007, the Company granted 7,000 shares of restricted common stock to certain of its employees. As of March 31, 2009, 3,360 of these restricted shares were unvested and subject to forfeiture.

12. INCOME TAXES

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

During the quarter ended March 31, 2009, the Company's taxable REIT subsidiaries recorded $533,000 of income tax expense for income attributable to those subsidiaries, and the portion of earnings retained based on Code Section 162(m) limitations. During the quarter ended March 31, 2009, the Company recorded $5.9 million of income tax expense for a portion of earnings retained based on Section 162(m) limitations. The effective tax rate was 54% for the quarter ended March 31, 2009

During the quarter ended March 31, 2008, FIDAC, a taxable REIT subsidiary, recorded $734,000 of income tax expense for income and for the portion of earnings retained based on Code Section 162(m) limitations. During the quarter ended March 31, 2008, the Company recorded $3.9 million of income tax expense for a portion of earnings retained based on Section 162(m) limitations. The effective tax rate was 51% for the quarter ended March 31, 2008.

The Company's effective tax rate was 54%, and 51% for the quarters ended March 31, 2009 and 2008, respectively. These rates differed from the federal statutory rate as a result of state and local taxes and permanent difference pertaining to employee remuneration as discussed above.

The statutory combined federal, state, and city corporate tax rate is 45%. This amount is applied to the amount of estimated REIT taxable income retained (if any, and only up to 10% of ordinary income as all capital gain income is distributed) and to taxable income earned at the taxable subsidiaries. Thus, as a REIT, the Company's effective tax rate is significantly less as it is allowed to deduct dividend distributions.

13. LEASE COMMITMENTS AND CONTINGENCIES

The Company has a non-cancelable lease for office space, which commenced in May 2002 and expires in December 2009. The Company's aggregate future minimum lease payments total $399,000. Merganser has a non-cancelable lease for office space, which commenced on May 2003 and expires in May 2014. The following table details the lease payments, net of sub-lease receipts

Year Ending December	Lease Commitment	Sublease Income	Net Amo
	(dollars in thousands)		
2009 (remaining)	$450	$101	$
2010	608	56	
2011	632	-	
2012	642	-	
2013	682	-	
Thereafter	189	-	
	$3,203	$157	$3,

From time to time, the Company is involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material effect on the Company's consolidated financial statements and therefore no accrual is required as of March 31, 2009 and December 31, 2008.

Merganser's prior owners may receive additional consideration as an earn-out during 2012 if Merganser meets specific performance goals under the merger agreement. The Company cannot currently calculate how much consideration will be paid under the earn-out provisions because the payment amount will vary depending upon whether and the extent to which Merganser achieves specific performance goals. Any amounts paid under this provision will be recorded as additional goodwill.

14. INTEREST RATE RISK

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

Investment Securities and the Company's ability to realize gains from the sale of these assets. A decline in the value of the Investment Securities pledged as collateral for borrowings under repurchase agreements could result in the counterparties demanding additional collateral pledges or liquidation of some of the existing collateral to reduce borrowing levels. Liquidation of collateral at losses could have an adverse accounting impact, as discussed in Note 1.

The Company seeks to manage the extent to which net income changes as a function of changes in interest rates by matching adjustable-rate assets with variable-rate borrowings. The Company may seek to mitigate the potential impact on net income of periodic and lifetime coupon adjustment restrictions in the portfolio of Investment Securities by entering into interest rate agreements such as interest rate caps and interest rate swaps. As of March 31, 2009, the Company entered into interest rate swaps to pay a fixed rate and receive a floating rate of interest, with a total notional amount of $17.3 billion.

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

15. RELATED PARTY TRANSACTIONS

At March 31, 2009 and December 31, 2008, the Company had lent $452.5 million and $562.1 million, respectively, to Chimera in an overnight reverse repurchase agreement. This amount is included at the principal amount which approximates fair value in the Company's Statement of Financial Condition. The interest rate at March 31, 2009 and December 31, 2008 was at the market rate of 2.01% and 1.43%, respectively. The collateral for this loan is mortgage-backed securities with a fair value of $532.1 million and $680.8 million at March 31, 2009 and December 31, 2008, respectively.

At March 31, 2009 the Company had $885.7 million of repurchase agreements outstanding with RCap. The weighted average interest rate is 0.80% and the terms are one day to one month. These agreements are collateralized by agency mortgage backed securities, with an estimated market value of $965.2 million.

17. SUBSEQUENT EVENTS

On April 21, 2009, the Company purchased approximately 25.0 million shares of Chimera common stock for approximately $74.9 million in connection with Chimera's secondary offering. Chimera is managed by FIDAC, and the Company owns approximately 8.5% of Chimera's common stock.

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

Special Note Regarding Forward-Looking Statements

Certain statements contained in this quarterly report, and certain statements contained in our future filings with the Securities and Exchange Commission (the "SEC" or the "Commission"), in our press releases or in our other public or shareholder communications may not be based on historical facts and are "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements, which are based on various assumptions, (some of which are beyond our control) may be identified by reference to a future period or periods, or by the use of forward-looking terminology, such as "may," "will," "believe," "expect," "anticipate," "continue," or similar terms or variations on those terms, or the negative of those terms. Actual results could differ materially from those set forth in forward-looking statements due to a variety of factors, including, but not limited to, changes in interest rates, changes in the yield curve, changes in prepayment rates, the availability of mortgage-backed securities and other securities for purchase, the availability of financing, and, if available, the terms of any financings, changes in the market value of our assets, changes in business conditions and the general economy, changes in governmental regulations affecting our business, and our ability to maintain our classification as a REIT for federal income tax purposes, and risks associated with the investment advisory business of our subsidiaries, including the removal by their clients of assets they manage, their regulatory requirements, and competition in the investment advisory business, and risks associated with the broker dealer business of our subsidiary. For a discussion of the risks and uncertainties which could cause actual results to differ from those contained in the forward-looking statements, see our most recent Annual Report on Form 10-K and any subsequent Quarterly Reports on Form 10-Q. We do not undertake and specifically disclaim any obligation, to publicly release the result of any revisions which may be made to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

Overview

We are a REIT that owns and manages a portfolio of principally mortgage-backed securities. Our principal business objective is to generate net income for distribution to our stockholders from the spread between the interest income on our investment securities and the costs of borrowing to finance our acquisition of investment securities and from dividends we receive from our taxable REIT subsidiaries. FIDAC and Merganser are our wholly-owned taxable REIT subsidiaries that are registered investment advisors that generate advisory and service fee income. RCap is our wholly- owned broker dealer taxable REIT subsidiary which generates fee income.

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

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

The remainder of our assets, comprising not more than 25% of our total assets, may consist of other qualified REIT real estate assets which are unrated or rated less than high quality, but which are at least "investment grade" (rated "BBB" or better by Standard & Poor's Corporation ("S&P") or the equivalent by another nationally recognized rating agency) or, if not rated, we determine them to be of comparable credit quality to an investment which is rated "BBB" or better. In addition, we may directly or indirectly invest part of

this remaining 25% of our assets in other types of securities, including without limitation, unrated debt, equity or derivative securities, to the extent consistent with our REIT qualification requirements. The derivative securities in which we invest may include securities representing the right to receive interest only or a disproportionately large amount of interest, as well as inverse floaters, which may have imbedded leverage as part of their structural characteristics.

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

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

The results of our operations are affected by various factors, many of which are beyond our control. Our results of operations primarily depend on, among other things, our net interest income, the market value of our assets and the supply of and demand for such assets. Our net interest income, which reflects the amortization of purchase premiums and accretion of discounts, varies primarily as a result of changes in interest rates, borrowing costs and prepayment speeds, the behavior of which involves various risks and uncertainties. Prepayment speeds, as reflected by the Constant Prepayment Rate, or CPR, and interest rates vary according to the type of investment, conditions in financial markets, competition and other factors, none of which can be predicted with any certainty. In general, as prepayment speeds on our Mortgage-Backed Securities portfolio increase, related purchase premium amortization increases, thereby reducing the net yield on such assets. The CPR on our Investment Securities portfolio averaged 16% and 15% for the quarters ended March 31, 2009 and 2008, respectively. Since changes in interest rates may significantly affect our activities, our operating results depend, in large part, upon our ability to effectively manage interest rate risks and prepayment risks while maintaining our status as a REIT.

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

	Average Investment Securities Held (1)	Total Interest Income	Yield on Average Investment Securities	Average Balance of Repurchase Agreements	Insert Expense	Average Cost of Funds
	(ratios for the quarters have been annualized, dollars in thousa					

Quarter Ended March 31, 2009	$54,763,268	$716,015	5.23%	$48,497,444	$378,625	3.12%
Quarter Ended December 31, 2008	$53,838,665	$740,282	5.50%	$47,581,332	$450,805	3.79%
Quarter Ended September 30, 2008	$57,694,277	$810,659	5.62%	$51,740,645	$458,250	3.54%
Quarter Ended June 30, 2008	$56,197,550	$773,359	5.50%	$50,359,825	$442,251	3.51%
Quarter Ended March 31, 2008	$56,119,584	$791,128	5.64%	$51,399,101	$537,606	4.18%

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

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

Quarter Ended	CPR
March 31, 2009	16%
December 31, 2008	10%
September 30, 2008	11%
June 30, 2008	16%
March 31, 2008	15%

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

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

For the purposes of computing ratios relating to equity measures, throughout this report, equity includes Series B preferred stock, which has been treated under accounting principles generally accepted in the United States, or GAAP, as temporary equity. For the discussion purposes in the Management Discussion and Analysis of Financial Condition and Results of Operations, net income attributable to controlling interest is referred to as net income.

Recent Developments

The liquidity crisis which commenced in August 2007 escalated throughout 2008 and during the first quarter of 2009. 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 is intended to 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. 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.

Subsequent to June 30, 2008, there were increased market concerns about Freddie Mac and Fannie Mae's ability to withstand future credit losses associated with securities held in their investment portfolios, and on which they provide guarantees, without the direct support of the federal government. In September 2008 Fannie Mae and Freddie Mac were placed into the conservatorship of the Federal Housing Finance Agency, or FHFA, their federal regulator, pursuant to its powers under The Federal Housing Finance Regulatory Reform Act of 2008, a part of the Housing and Economic Recovery Act of 2008. As the conservator of Fannie Mae and Freddie Mac, the FHFA controls and directs the operations of Fannie Mae and Freddie Mac and may (1) take over the assets of and operate Fannie Mae and Freddie Mac with all the powers of the shareholders, the directors, and the officers of Fannie Mae and Freddie Mac and conduct all business of Fannie Mae and Freddie Mac; (2) collect all obligations and money due to Fannie Mae and Freddie Mac; (3) perform all functions of Fannie Mae and Freddie Mac which are consistent with the conservator's appointment; (4) preserve and conserve the assets and property of Fannie Mae and Freddie Mac; and (5) contract for assistance in fulfilling any function, activity, action or duty of the conservator.

In addition to FHFA becoming the conservator of Fannie Mae and Freddie Mac, (i) the U.S. Department of Treasury and FHFA have entered into preferred stock purchase agreements between the U.S. Department of Treasury and Fannie Mae and Freddie Mac pursuant to which the U.S. Department of Treasury will ensure that each of Fannie Mae and Freddie Mac maintains a positive net worth; (ii) the U.S. Department of Treasury has established a new secured lending credit facility which will be available to Fannie Mae, Freddie Mac, and the Federal Home Loan Banks, which is intended to serve as a liquidity backstop, which will be available until December 2009; and (iii) the U.S. Department of Treasury has initiated a temporary program to purchase mortgage-backed securities issued by Fannie Mae and Freddie Mac. Given the highly fluid and evolving nature of these events, it is unclear how our business will be impacted. Based upon the further activity of the U.S. government or market response to developments at Fannie Mae or Freddie Mac, our business could be adversely impacted.

The Emergency Economic Stabilization Act of 2008, or EESA, was recently enacted. The EESA provides the U.S. Secretary of the Treasury with the authority to establish a Troubled Asset Relief Program, or TARP, to purchase from financial institutions up to $700 billion of equity or preferred securities, residential or commercial mortgages and any securities, obligations, or other instruments that are based on or related to such mortgages, that in each case was originated or issued on or before March 14, 2008, as well as any other financial instrument that the U.S. Secretary of the Treasury, after consultation with the Chairman of the Board of Governors of the Federal Reserve System, determines the purchase of which is necessary to promote financial market stability, upon transmittal of such determination, in writing, to the appropriate committees of the U.S. Congress. The EESA also provides for a program that would allow companies to insure their troubled assets.

In addition, the U.S. Government, Federal Reserve and other governmental and regulatory bodies have taken or are considering taking other actions to address the financial crisis. The Term Asset-Backed Securities Loan Facility, or TALF, was first announced by the U.S. Department of Treasury, or the Treasury, on November 25, 2008, and has been expanded in size and scope since its initial announcement. Under the TALF, the Federal Reserve Bank of New York makes non-recourse loans to borrowers to fund their purchase of eligible assets, currently certain asset-backed securities but not residential mortgage-backed securities. In addition, on March 23, 2009 the government announced that the Treasury in conjunction with the Federal Deposit Insurance Corporation, or FDIC, and the Federal Reserve, would create the Public-Private Investment Program, or PPIP. The PPIP aims to recreate a market for specific illiquid residential and commercial loans and securities through a number of joint public and private investment funds. The PPIP is designed to draw new private capital into the market for these securities and loans by providing government equity co-investment and attractive public financing. As these programs are still in early stages of development, it is not possible for us to predict how these programs will impact our business.

There can be no assurance that the EESA, TALF, PPIP or other policy initiatives will have a beneficial impact on the financial markets, including current extreme levels of volatility. We cannot predict whether or when such actions may occur or what impact, if any, such actions could have on our business, results of operations and financial condition.

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

Critical Accounting Policies

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

Fair Value of Investment Securities: All assets classified as available-for-sale are reported at fair value, based on market prices. Although we generally intend to hold most of our Investment Securities until maturity, we may, from time to time, sell any of our Investment Securities as part our overall management of our portfolio. Accordingly, we are required to classify all of our Investment Securities as available-for-sale. Our policy is to obtain fair values from independent sources. Fair values from independent sources are compared to internal prices for reasonableness. Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. The determination of whether a security is other-than-temporarily impaired involves judgments and assumptions based on subjective and objective factors. Consideration is given to (1) the intent to sell the Investment Securities, (2) it is more likely than not that it will be required to sell the Investment Securities before recovery, or (3) it does not expect to recover the entire amortized cost basis of the Investment Securities. Further, the security is analyzed for credit loss, (the difference between the present value of cash flows expected to be collected and the amortized cost basis). The credit loss, if any, will then be recognized in the statement of earnings, while the balance of impairment related to other factors will be recognized in other comprehensive income ("OCI").

Interest Income: Interest income is accrued based on the outstanding principal amount of the Investment Securities and their contractual terms.

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

Derivative Financial Instruments/Hedging Activity : Prior to the fourth quarter of 2008, we designated interest rate swaps as cash flow hedges, whereby the swaps were recorded at fair value on the balance sheet as assets and liabilities with any changes in fair value recorded in accumulated other comprehensive income. In a cash flow hedge, a swap would exactly match the pricing date of the relevant repurchase agreement. Through the end of the third quarter of 2008, we continued to be able to match the swaps with the repurchase agreements therefore entering into effective hedge transactions. However, due to the volatility of the credit markets, it is no longer practical to match the pricing dates of both the swaps and the repurchase agreements.

As a result, we voluntarily discontinued hedge accounting in the fourth quarter of 2008 through a combination of de-designating previously defined hedge relationships and not designating new contracts as cash flow hedges. The de-designation of cash flow hedges was done in accordance with Derivatives Implementation Group (DIG) Issue Nos. G3, G17, G18 & G20, which generally require that the net derivative gain or loss related to the discontinued cash flow hedge should continue to be reported in accumulated other comprehensive income, unless it is probable that the forecasted transaction will not occur by the end of the originally specified time period or within an additional two-month period of time thereafter. As such we continue to hold repurchase agreements in excess of swap contracts and have no indication that interest payments on the hedged repurchase agreements are in jeopardy of discontinuing. Therefore, the deferred losses related to these derivatives that have been de-designated were not recognized immediately and are expected to be reclassified into earnings during the contractual terms of the swap agreements starting as of October 1, 2008. Changes in the unrealized gains or losses on the interest rate swaps subsequent to September 30, 2008 are reflected in our income statement.

Repurchase Agreements: We finance the acquisition of our Investment Securities through the use of repurchase agreements. Repurchase agreements are treated as collateralized financing transactions and are carried at their contractual amounts, including accrued interest, as specified in the respective agreements. Repurchase agreements entered into by RCap are matched with specific reverse repurchase agreements and are recorded on trade date with the duration of such repurchase agreements mirroring those of the matched reverse repurchase agreements. These repurchase agreements are recorded at the contract amount and margin calls are filled by RCap as required based on any deficiencies in collateral versus the contract price. RCap generates income from the spread between what is earned on the reverse repurchase agreements and what is paid on the repurchase agreements. Cash flows related to RCap's matched book activity are included in cash flows from operating activity.

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

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

Recent Accounting Pronouncements:

On January 1, 2009, we adopted SFAS 160, Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51, which requires us to make certain changes to the presentation of our financial statements. This standard requires us to classify noncontrolling interests (previously referred to as "minority interest") as part of consolidated net income and to include the accumulated amount of noncontrolling interests as part of stockholders' equity. The net income amounts we have previously reported are now presented as "Net income attributable to controlling interest". Similarly, in our presentation of stockholders' equity, we distinguish between equity amounts attributable to controlling interest and amounts attributable to the noncontrolling interests - previously classified as minority interest outside of stockholders' equity. For

the quarter ended March 31, 2009 and year-ended December 31, 2008 we do not have any non controlling interest. In addition to these financial reporting changes, SFAS 160 provides for significant changes in accounting related to noncontrolling interests; specifically, increases and decreases in our controlling financial interests in consolidated subsidiaries will be reported in equity similar to treasury stock transactions. If a change in ownership of a consolidated subsidiary results in loss of control and deconsolidation, any retained ownership interests are remeasured with the gain or loss reported in net earnings. Since December 31, 2008, we did not have any non controlling interest in any of its subsidiaries. However, the retrospective effect of the presentation and disclosure requirement under SFAS 160 will be applied.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations, ("SFAS 141R") which replaces SFAS No. 141, Business Combinations. SFAS 141R establishes principles and requirements for recognizing and measuring identifiable assets and goodwill acquired, liabilities assumed and any noncontrolling interest in a business combination at their fair value at acquisition date. SFAS 141R alters the treatment of acquisition-related costs, business combinations achieved in stages (referred to as a step acquisition), the treatment of gains from a bargain purchase, the recognition of contingencies in business combinations, the treatment of in-process research and development in a business combination as well as the treatment of recognizable deferred tax benefits. SFAS 141R is effective for business combinations closed in fiscal years beginning after December 15, 2008. As SFAS 141R is applicable to business acquisitions completed after January 1, 2009 and we did not make any business acquisitions during the quarter ended March 31, 2009, the adoption of SFAS 141R did not have a material impact on our consolidated financial statements.

In February 2008, FASB issued FASB Staff Position No. FAS 140-3 Accounting for Transfers of Financial Assets and Repurchase Financing Transactions ("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 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 are readily obtainable in the market; and (4) the financial instrument and the repurchase agreement are not coterminous. This FSP was effective for us on January 1, 2009. The implementation of this FSP did not have a material effect on our financial statements.

In March 2008, the FASB issued SFAS No. 161 ("SFAS 161"), Disclosures about Derivative Instruments and Hedging Activities, and an amendment of FASB Statement No. 133. SFAS 161 attempts to improve the transparency of financial reporting by mandating the provision of 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 mandates, SFAS 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts, 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 was effective for us as of January 1, 2009 and was adopted prospectively. We discontinued hedge accounting as of September 30, 2008 and therefore the effect of the adoption of SFAS 161 will be a minimal increase in footnote disclosures. A table of the effect of the de-designated swap transactions will be included to indicate the effect on OCI and Other Income (Expense).

On October 10, 2008, FASB issued FASB Staff Position (FSP) 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active ("FSP 157-3"), in response to the deterioration of the credit markets. This FSP provides guidance clarifying how SFAS 157 should be applied when valuing securities in markets that are not active. The guidance provides an illustrative example that applies the objectives and framework of SFAS 157, utilizing management's internal cash flow and discount rate assumptions when relevant observable data does not exist. It further clarifies how observable market information and market quotes should be considered when measuring fair value in an inactive market. It reaffirms the notion of fair value as an exit price as of the measurement date and that fair value analysis is a transactional process and should not be broadly applied to a group of assets. FSP 157-3 was effective upon issuance including prior periods for which financial statements have not been issued. FSP 157-3 does not have a material effect on the fair value of our assets as we intend to continue to hold assets that can be valued via level 1 and level 2 criteria, as defined under SFAS 157.

On October 3, 2008 the Emergency Economic Stabilization Act of 2008 (the EESA) was signed into law. Section 133 of the EESA mandated that the Securities and Exchange Commission (the SEC) conduct a study on mark-to-market accounting standards. The SEC provided its study to the US Congress on December 30, 2008.

Part of the recommendations within the study indicated that "fair value requirements should be improved through development of application and best practices guidance for determining fair value in illiquid or inactive markets." As a result of this study and the recommendations therein, the FASB issued Staff Position (FSP) FAS157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly. This FSP provides additional guidance on determining fair value when the volume and level of activity for the asset or liability have significantly decreased when compared with normal market activity for the asset or liability (or similar assets or liabilities). The FSP gives specific factors to evaluate if there has been a decrease in normal market activity and if so, provides a methodology to analyze transactions or quoted prices and make necessary adjustments to fair value in accordance with Statement 157. The objective is to determine the point within a range of fair value estimates that is most representative of fair value under current market conditions. FSP FAS157-4 is effective for interim and annual reporting periods ending after June 15, 2009 with early adoption permitted for periods ending after March 15, 2009 and we decided to early adopt FSP FAS 157-4. The implementation of FSP FAS157-4 has no major impact on the manner in which we estimate fair value, nor does it have any impact on current disclosure.

Additionally, in conjunction with FSP 157-4, the FASB issued FAS 115-2 and FAS 124-2, Recognition and Presentation of Other Than Temporary Impairments. The objective of the new guidance is to make impairment guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments (OTTI) on debt and equity securities in financial statements. This EESA guidance was also the result of the SEC mark-to-market study mandated under the EESA. The SEC's recommendation was to "evaluate the need for modifications (or the elimination) of current OTTI guidance to provide for a more uniform system of impairment testing standards for financial instruments". The guidance revises the OTTI evaluation methodology. Previously the analytical focus was on whether the company had the "intent and ability to retain its investment in the debt security for a period of time sufficient to allow for any anticipated recovery in fair value". Now the focus is on whether we have (1) the intent to sell the Investment Securities, (2) it is more likely than not that it will be required to sell the Investment Securities before recovery, or (3) it does not expect to recover the entire amortized cost basis of the Investment Securities. Further, the security is analyzed for credit loss, (the difference between the present value of cash flows expected to be collected and the amortized cost basis). The credit loss, if any, will then be recognized in the statement of earnings, while the balance of impairment related to other factors will be recognized in OCI. FAS 115-2 and FAS 124-2 are effective for all interim and annual periods ending after June 15, 2009 with early adoption permitted for periods ending after March 15, 2009 and we decided to early adopt FSP FAS 115-2 and FSP FAS 124-2. For the quarter ended March 31, 2009 we did not have unrealized losses on Investment Securities that were deemed other-than-temporary.

On April 9, 2009, the FASB also issued FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments. The rule/guideline requires disclosures about fair value of financial instruments for interim reporting periods as well as in annual financial statements. The effective date of this rule/guideline is for interim reporting periods ending after June 15, 2009. Our early adoption did not impact financial reporting as all financial instruments are currently reported at fair value in both the interim and annual reports.

Results of Operations: For the Quarters Ended March 31, 2008 and 2009

Net Income Summary

For the quarter ended March 31, 2009, our net income was $349.9 million or

$0.64 basic income per average share related to common shareholders, as compared to $243.0 million net income or $0.54 basic net income per average share for the quarter ended March 31, 2008. Net income per average share increased by $0.10 per average share available to common shareholders and total net income increased $106.9 million for the quarter ended March 31, 2009, when compared to the quarter ended March 31, 2008. We attribute the increase in total net income for the quarter ended March 31, 2009 from the quarter ended March 31, 2008 primarily to increase in net interest income of $83.9 million and recording of unrealized gain related to interest rate swaps in the first quarter of 2009. An unrealized gain of $35.5 million was recorded in the income statement for the

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quarter ended March 31, 2009 as the result of de-designation of cash flow hedges. Prior to the fourth quarter of 2008, we recorded changes in the fair values in our interest rate swaps in the Accumulated Other Comprehensive Income in our Statement of Financial Condition.

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

	Quarter Ended March 31, 2009	Quarte March 3
Interest income	$716,015	$
Interest expense	378,625	
Net interest income	337,390	
Other income:		
Investment advisory and service fees	7,761	
Gain on sale of investment securities	5,023	
Income from trading securities	-	
Dividend income from available-for-sale equity securities	918	
Unrealized gain on interest rate swaps	35,545	
Total other income	49,247	
Expenses:		
Distribution fees	428	
General and administrative expenses	29,882	
Total expenses	30,310	
Income before income taxes and noncontrolling interest	356,327	
Income taxes	6,434	
Net income	349,893	
Noncontrolling interest	-	
Net Income attributable to controlling interest	349,893	

Dividends on preferred stock	4,626	
Net income available to common shareholders	$345,267	$
Weighted average number of basic common shares outstanding	542,903,110	443,
Weighted average number of diluted common shares outstanding	548,551,328	452,
Basic net income per average common share	$0.64	
Diluted net income per average common share	$0.63	
Average total assets	$59,157,435	$56,
Average equity	$7,751,275	$5,
Return on average total assets	2.37%	
Return on average equity	18.06%	

Interest Income and Average Earning Asset Yield

We had average earning assets of $54.8 billion for the quarter ended March 31, 2009. We had average earning assets of $56.1 billion for the quarter ended March 31, 2008. Our primary source of income is interest income. Our interest income was $716.0 million for the quarter ended March 31, 2009 and $791.1 million for the quarter ended March 31, 2008. The yield on average Investment Securities was 5.23% and 5.64%, for the quarters ending March 31, 2009 and 2008,

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respectively. The prepayment speeds increased to an average of 16% CPR for the quarter ended March 31, 2009 from an average of 15% CPR for the quarter ended March 31, 2008. Interest income for the quarter ended March 31, 2009, when compared to interest income for the quarter ended March 31, 2008, declined by $75.1 million due to the decline in the average earning assets of $1.3 billion and the decline in the yield on earning assets of 41 basis points.

Interest Expense and the Cost of Funds

Our largest expense is the cost of borrowed funds. We had average borrowed funds of $48.5 billion and total interest expense of $378.6 million for the quarter ended March 31, 2009. We had average borrowed funds of $51.4 billion and total interest expense of $537.6 million for the quarter ended March 31, 2008. Our average cost of funds was 3.12% for the quarter ended March 31, 2009 and 4.18% for the quarter ended March 31, 2008. The cost of funds rate decreased by 106 basis points and the average borrowed funds decreased by $2.9 billion for the quarter ended March 31, 2009 when compared to the quarter ended March 31, 2008. Interest expense for the quarter ended March 31, 2009 decreased by $159.0 million, when compared to the quarter ended March 31, 2008, due to the decrease in the average borrowed funds and the average cost of funds rate. Since a substantial portion of our repurchase agreements are short term, changes in market rates are directly reflected in our interest expense. Our average cost of funds was 2.66% above average one-month LIBOR and 1.38% above average six-month LIBOR for the quarter ended March 31, 2009.

The table below shows our average borrowed funds and average cost of funds as compared to average one-month and average six-month LIBOR for the quarter ended March 31, 2009, the year ended December 31, 2008 and four quarters in 2008.

Average Cost of Funds

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

	Average Borrowed Funds	Interest Expense	Average Cost of Funds	Average One-Month LIBOR	Average Six-Month LIBOR	Average One-Month LIBOR Relative to Average Six-Month LIBOR	Avera of F Relati Aver One-M LIBO
For the Quarter Ended March 31, 20099	$48,497,444	$378,625	3.12%	0.46%	1.74%	(1.28%)	2.
For the Year Ended December 31, 2008	$50,270,226	$1,888,912	3.76%	2.68%	3.06%	(0.38%)	1.
For the Quarter Ended December 31, 2008	$47,581,332	$450,805	3.79%	2.23%	2.94%	(0.71%)	1.
For the Quarter Ended September 30, 2008	$51,740,645	$458,250	3.54%	2.62%	3.19%	(0.57%)	0.
For the Quarter Ended June 30, 2008	$50,359,825	$442,251	3.51%	2.59%	2.93%	(0.34%)	0.
For the Quarter Ended March 31, 2008	$51,399,101	$537,606	4.18%	3.31%	3.18%	0.13%	0.

Net Interest Income

Our net interest income, which equals interest income less interest expense, totaled $337.4 million for the quarter ended March 31, 2009 and $253.5 million for the quarter ended March 31, 2008. Our net interest income increased for the quarter ended March 31, 2009, as compared to the quarter ended March 31, 2008, because of increased interest rate spread. Our net interest spread, which equals the yield on our average assets for the period less the average cost of funds for the period, was 1.46% for the quarter ended March 31, 2008 as compared 2.11% for the quarter ended March 31, 2009. This 65 basis point increase in interest rate spread for first quarter of 2009 over the spread for first quarter of 2008 was the result in the decrease in the average cost of funds of 106 basis points, which was only partially offset by a decrease in average yield on average interest earning assets of 41 basis points.

The table below shows our interest income by average Investment Securities held, total interest income, yield on average interest earning assets, average balance of repurchase agreements, interest expense, average cost of funds, net interest income, and net interest rate spread for the quarter ended March 31, 2009, the year ended December 31, 2008 and four quarters in 2008.

Net Interest Income

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

	Average Investment Securities	Total Interest	Average Interest Earning	Average Balance of Repurchase	Interest	Average Cost of	In

	Held	Income	Assets	Agreements	Expense	Funds	I
For the Quarter Ended March 31, 2009	$54,763,268	$716,015	5.23%	$48,497,444	$378,625	3.12%	$
For the Year Ended December 31, 2008	$55,962,519	$3,115,428	5.57%	$50,270,226	$1,888,912	3.76%	$1,
For the Quarter Ended December 31, 2008	$53,838,665	$740,282	5.50%	$47,581,332	$450,805	3.79%	$
For the Quarter Ended September 30, 2008	$57,694,277	$810,659	5.62%	$51,740,645	$458,250	3.54%	$
For the Quarter Ended June 30, 2008	$56,197,550	$773,359	5.50%	$50,359,825	$442,251	3.51%	$
For the Quarter Ended March 31, 2008	$56,119,584	$791,128	5.64%	$51,399,101	$537,606	4.18%	$

Investment Advisory and Service Fees

FIDAC and Merganser are registered investment advisors specializing in managing fixed income securities. At March 31, 2009, FIDAC and Merganser had under management approximately $8.5 billion in net assets and $16.3 billion in gross assets, compared to $3.2 billion in net assets and $12.7 billion in gross assets at March 31, 2008. Net investment advisory and service fees net of distribution fees for the quarters ended March 31, 2009 and 2008 totaled $7.3 million and $6.0 million, respectively. Gross assets under management will vary from time to time because of changes in the amount of net assets FIDAC and Merganser manage as well as changes in the amount of leverage used by the various funds and accounts FIDAC manages.

Gains and Losses on Sales of Investment Securities

For the quarter ended March 31, 2009, we sold Investment Securities with a carrying value of $835.7 million for aggregate net gain of $5.0 million. For the quarter ended March 31, 2008, we sold Investment Securities with a carrying value of $4.1 billion for a net gain of $9.4 million. We do not expect to sell assets on a frequent basis, but may from time to time sell existing assets to move into new assets, which our management believes might have higher risk-adjusted returns, or to manage our balance sheet as part of our asset/liability management strategy.

Income from Trading Securities

For the quarter ended March 31, 2009, we did not have income from trading securities. Gross income from trading securities totaled $1.9 million for the quarter ended March 31, 2008.

Dividend Income from Available-For-Sale Equity Securities

Dividend income from our investment in Chimera totaled $918,000 and $941,000 for the quarter ended March 31, 2009 and 2008, respectively.

General and Administrative Expenses

General and administrative (or G&A) expenses were $29.9 million for the quarter ended March 31, 2009 and $24.0 million for the quarter ended March 31, 2008. G&A expenses as a percentage of average total assets was 0.20% and 0.17%, for the quarters ended March 31, 2009 and 2008, respectively. The increase in G&A expenses of $5.9 million for the quarter ended March 31, 2009 was primarily the result of increased compensation, directors and officers insurance and additional costs related to our subsidiaries. Our employees increased from 41 at March 31, 2008 to 69 at March 31, 2009.

The table below shows our total G&A expenses as compared to average total assets and average equity for the quarter ended March 31, 2009, the year ended December 31, 2008 and four quarters in 2008.

G&A Expenses and Operating Expense Ratios

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

	Total G&A Expenses	Total G&A Expenses/Average Assets	Total G&A Expenses/Aver Equity
For the Quarter Ended March 31, 2009	$29,882	0.20%	1.54%
For the Year Ended December 31, 2008	$103,622	0.18%	1.55%
For the Quarter Ended December 31, 2008	$26,957	0.18%	1.50%
For the Quarter Ended September 30, 2008	$25,455	0.17%	1.40%
For the Quarter Ended June 30, 2008	$27,215	0.18%	1.59%
For the Quarter Ended March 31, 2008	$23,995	0.17%	1.64%

Net Income and Return on Average Equity

Our net income was $349.9 million for the quarter ended March 31, 2009 and net income was $243.0 million for the quarter ended March 31, 2008. Our annualized return on average equity was 18.06% for the quarter ended March 31, 2009 and 16.66% for the quarter ended March 31, 2008. Net interest income increased by $83.9 million for the quarter ended March 31, 2009, as compared to the quarter ended March 31, 2008, due to the increase in interest rate spread. In addition to the increase in interest rate spread, an unrealized gain on interest rate swaps of $35.5 million was recorded in the income statement for the quarter ended March 31, 2009, as the result of de-designation of cash flow hedges. Prior to the fourth quarter of 2008, we recorded changes in the fair values in our interest rate swaps in Accumulated Other Comprehensive Income in our Statement of Financial Condition.

The table below shows our net interest income, net investment advisory and service fees, gain (loss) on sale of Mortgage-Backed Securities and termination of interest rate swaps, loss on other-than-temporarily impaired securities, income from trading securities, G&A expenses, income taxes, each as a percentage of average equity, and the return on average equity for the quarter ended March 31, 2009, the year ended December 31, 2008 and four quarters in 2008.

Components of Return on Average Equity

(Ratios for the quarters have been annualized)

	Net	Gain/(Loss) on Sale of Mortgage-Backed Securities and Realized and	Loss on	Income	Dividend

	Net Interest Income/ Average Equity	Investment Advisory and Service Fees/Average Equity	Unrealized Gain/(Loss) Interest Rate Swaps/ Average Equity	other-than-temporarily impaired securities/ Average Equity	(loss) from trading securities /Average Equity	income from available-for-sale equity securities	Ex Av Eq
For the Quarter Ended March 31, 2009	17.41%	0.38%	2.09%	-	-	0.05%	(
For the Year Ended December 31, 2008	18.36%	0.39%	(11.34%)	(0.48%)	0.15%	0.04%	(
For the Quarter Ended December 31, 2008	16.06%	0.38%	(42.63%)	-	(0.11%)	0.03%	(
For the Quarter Ended September 30, 2008	19.52%	0.41%	(0.07%)	(1.76%)	0.42%	0.03%	(
For the Quarter Ended June 30, 2008	19.40%	0.35%	0.16%	-	0.13%	0.03%	(
For the Quarter Ended March 31, 2008	17.38%	0.41%	0.64%	-	0.13%	0.06%	(

Financial Condition

Investment Securities, Available for Sale

All of our Mortgage-Backed Securities at March 31, 2009 and December 31, 2008 were adjustable-rate or fixed-rate mortgage-backed securities backed by single-family mortgage loans. All of the mortgage assets underlying these mortgage-backed securities were secured with a first lien position on the underlying single-family properties. All of our mortgage-backed securities were Freddie Mac, Fannie Mae or Ginnie Mae mortgage pass-through certificates or CMOs, which carry an implied "AAA" rating. All of our agency debentures are callable and carry an implied "AAA" rating. We carry all of our earning assets at fair value. We accrete discount balances as an increase in interest income over the life of discount Investment Securities and we amortize premium balances as a decrease in interest income over the life of premium Investment Securities. At March 31, 2009 and December 31, 2008 we had on our balance sheet a total of $60.0 Million and, $64.4 million, respectively, of unamortized discount (which is the difference between the remaining principal value and current historical amortized cost of our Investment Securities acquired at a price below principal value) and a total of $728.3 million and $619.5 million, respectively, of unamortized premium (which is the difference between the remaining principal value and the current historical amortized cost of our Investment Securities acquired at a price above principal value).

We received mortgage principal repayments of $2.5 billion and $2.5 billion for the quarters ended March 31, 2009 and March 31, 2008, respectively. The average prepayment speed for the quarters ended March 31, 2009 and 2008 was 16%, and 15%, respectively. During the quarter ended March 31, 2009, the average CPR increased to 16% from 15% during the quarter ended March 31, 2008, due to an increase in foreclosure and refinancing activity. Given our current portfolio composition, if mortgage principal prepayment rates were to increase over the life of our mortgage-backed securities, all other factors being equal, our net interest income would decrease during the life of these mortgage-backed securities as we would be required to amortize our net premium balance into income over a shorter time period. Similarly, if mortgage principal prepayment rates were to decrease over the life of our mortgage-backed securities, all other factors being equal, our net interest income would increase during the life of these mortgage-backed securities as we would amortize our net premium balance over a longer time period.

The table below summarizes certain characteristics of our Investment Securities at March 31, 2009, December 31, 2008, September 30, 2008, June 30, 2008, and March 31, 2008.

Investment Securities

(dollars in thousands)

	Principal Amount	Net Premium	Amortized Cost	Amortized Cost/Principal Amount	Fair Value	F Va Pri A
At March 31, 2009	$56,718,404	$668,295	$57,386,699	101.18%	$58,785,456	1
At December 31, 2008	$54,508,672	$555,043	$55,063,715	101.02%	$55,645,940	1
At September 30, 2008	$55,211,123	$525,394	$55,736,517	100.95%	$55,459,280	1
At June 30, 2008	$58,304,678	$500,721	$58,805,399	100.86%	$58,749,300	1
At March 31, 2008	$56,006,707	$383,334	$56,390,041	100.68%	$56,853,862	1

The table below summarizes certain characteristics of our Investment Securities at March 31, 2009, December 31, 2008, September 30, 2008, June 30, 2008, and March 31, 2008. The index level for adjustable-rate Investment Securities is the weighted average rate of the various short-term interest rate indices, which determine the coupon rate.

Adjustable-Rate Investment Security Characteristics

(dollars in thousands)

	Principal Amount	Weighted Average Coupon Rate	Weighted Average Term to Next Adjustment	Weighted Average Lifetime Cap	Weighted Average Asset Yield	Pr at
At March 31, 2009	$19,558,480	4.66%	34 months	10.06%	3.74%	
At December 31, 2008	$19,540,152	4.75%	36 months	10.00%	3.93%	
At September 30, 2008	$19,310,012	5.27%	37 months	9.98%	4.65%	
At June 30, 2008	$18,418,637	5.16%	36 months	9.89%	4.54%	
At March 31, 2008	$17,487,518	5.19%	35 months	9.73%	4.40%	

Fixed-Rate Investment Security Characteristics

(dollars in thousands)

Principal Amount	Weighted Average Coupon Rate	Weighted Average Asset Yield	Princi Period E Investm

At March 31, 2009	$37,159,924	6.08%	5.64%
At December 31, 2008	$34,968,520	6.13%	5.84%
At September 30, 2008	$35,901,111	6.06%	5.82%
At June 30, 2008	$39,886,041	6.00%	5.70%
At March 31, 2008	$38,519,189	5.98%	5.80%

At March 31, 2009 and December 31, 2008, we held Investment Securities with coupons linked to various indices. The following tables detail the portfolio characteristics by index.

Adjustable-Rate Investment Securities by Index

March 31, 2009

	One-Month Libor	Six-Month Libor	Twelve Month Libor	12-Month Moving Average	11th District Cost of Funds	1-Year Treasury Index
Weighted Average Term to Next Adjustment	1 mo.	23 mo.	51 mo.	1 mo.	1 mo.	38 mo.
Weighted Average Annual Period Cap	6.39%	1.61%	2.01%	0.02%	1.05%	1.94%
Weighted Average Lifetime Cap at March 31, 2009	7.04%	11.20%	10.89%	9.19%	10.78%	10.83%
Investment Principal Value as Percentage of Investment Securities at March 31, 2009	7.10%	1.98%	19.48%	1.14%	0.66%	3.94%

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

Adjustable-Rate Investment Securities by Index

December 31, 2008

	One-Month Libor	Six-Month Libor	Twelve Month Libor	12-Month Moving Average	11th District Cost of Funds	1-Year Treasury Index
Weighted Average Term to Next Adjustment	1 mo.	25 mo.	55 mo.	1 mo.	1 mo.	37 mo.
Weighted Average Annual Period Cap	6.28%	1.95%	1.98%	0.00%	1.26%	1.93%
Weighted Average Lifetime Cap at December 31, 2008	7.07%	10.87%	10.92%	8.86%	11.35%	10.86%
Investment Principal Value as Percentage of Investment Securities at December 31, 2008	8.11%	2.53%	19.32%	0.99%	0.60%	4.12%

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

Reverse Repurchase Agreements

At March 31, 2009 and December 31, 2008, we lent $452.5 million and $562.1 million, respectively, to Chimera in an overnight reverse repurchase agreement.

This amount is included at fair value in our Statement of Financial Condition. The interest rate at March 31, 2009 and December 31, 2008 was at the market rate of 2.01% and 1.43%, respectively. The collateral for this loan is mortgage-backed securities.

Receivable from Prime Broker on Equity Investment

The net assets of the investment fund are subject to English bankruptcy law, which governs the administration of Lehman Brothers International (Europe) (LBIE), as well as the law of New York, which governs the contractual documents. Until our contractual documents with LBIE are terminated, the value of the assets and liabilities in our account with LBIE will continue to fluctuate based on market movements. We do not intend to terminate these contractual documents until LBIE's administrators have clarified the consequences of us doing so. We have not received notice from LBIE's administrators that LBIE has terminated the documents. LBIE's administrators have advised us that they can provide us with no additional information about our account at this time. As a result, we have presented the market value of our account with LBIE as of September 15, 2008 of $16.9 million, which is the date of the last statement we received from LBIE on the account's assets and liabilities. We can provide no assurance, however, that we will recover all or any portion of these assets following completion of LBIE's administration (and any subsequent liquidation). Based on the information known at March 31, 2009, a loss was not determined to be probable. If additional information indicates otherwise and it is determined that the loss is probable, the estimated loss will be reflected in the statement of operations

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Borrowings

To date, our debt has consisted entirely of borrowings collateralized by a pledge of our Investment Securities. These borrowings appear on our statement of financial condition as repurchase agreements. At March 31, 2009, we had established uncommitted borrowing facilities in this market with 30 lenders in amounts which we believe are in excess of our needs. All of our Investment Securities are currently accepted as collateral for these borrowings. However, we limit our borrowings, and thus our potential asset growth, in order to maintain unused borrowing capacity and thus increase the liquidity and strength of our financial condition.

At March 31, 2009, the term to maturity of our borrowings ranged from one day to ten years. Additionally, we have entered into structured borrowings giving the counterparty the right to call the balance prior to maturity. The weighted average original term to maturity of our borrowings was 263 days at March 31, 2009. At March 31, 2008, the term to maturity of our borrowings ranged from one day to ten years, with a weighted average original term to maturity of 266 days.

At March 31, 2009, the weighted average cost of funds for all of our borrowings was 2.78%, including the effect of the interest rate swaps, and the weighted average term to next rate adjustment was 219 days. At March 31, 2008, the weighted average cost of funds for all of our borrowings 3.85% and the weighted average term to next rate adjustment was 229 days.

Liquidity

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

Borrowings under our repurchase agreements increased by $2.3 billion to $49.0 billion at March 31, 2009, from $46.7 billion at December 31, 2008.

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

Under our repurchase agreements, we may be required to pledge additional assets to our repurchase agreement counterparties (i.e., lenders) in the event the estimated fair value of the existing pledged collateral under such agreements declines and such lenders demand additional collateral (a "margin call"), which may take the form of additional securities or cash. Similarly, if the estimated fair value of our pledged collateral increases due to changes in market interest rates of market factors, lenders may release collateral back to us. Specifically, margin calls result from a decline in the value of the our Mortgage-Backed Securities securing our repurchase agreements, prepayments on the mortgages securing such Mortgage-Backed Securities and to changes in the estimated fair value of such Mortgage-Backed Securities generally due to principal reduction of such Mortgage-Backed Securities from scheduled amortization and resulting from changes in market interest rates and other market factors. Through March 31, 2009, we did not have any margin calls on our repurchase agreements that we were not able to satisfy with either cash or additional pledged collateral. However, should prepayment speeds on the mortgages underlying our Mortgage-Backed Securities and/or market interest rates suddenly increase, margin calls on our repurchase agreements could result, causing an adverse change in our liquidity position.

The following table summarizes the effect on our liquidity and cash flows from contractual obligations for repurchase agreements, interest expense on repurchase agreements, the non-cancelable office lease and employment agreements at March 31, 2009. The table does not include the effect of net interest rate payments under our interest rate swap agreements. The net swap payments will fluctuate based on monthly changes in the receive rate, At March 31, 2009, the interest rate swaps had a negative fair value of $1.0 billion.

(dollars in thousands)

Contractual Obligations	Within One Year	One to Three Years	Three to Five Years	More th Five Yea
Repurchase agreements	$41,771,178	$4,630,000	$950,000	$1,600
Interest expense on repurchase				

agreements, based on rates at March 31, 2009	292,698	366,702	157,761	196
Long-term operating lease obligations	886	1,207	1,352	
Employment contracts	79,421	16,765	-	
Total	$42,144,183	$5,014,674	$1,109,113	$1,796

Stockholders' Equity

During the quarter ended March 31, 2009, we declared dividends to common shareholders totaling $272.2 million or $0.50 per share, which were paid on April 29, 2009. During the quarter ended March 31, 2009, we declared and paid dividends to Series A Preferred shareholders totaling $3.6 million or $0.492188 per share, and Series B Preferred shareholders totaling $978,000 or $0.375 per share.

During the quarter ended March 31, 2009, 55,887 options for an aggregate exercise price of $623,000 were exercised and 7,550 restricted shares were issued under the Long-Term Stock Incentive Plan, or Incentive Plan. During the quarter ended March 31, 2009, 1,355,961 shares of Series B Preferred Stock were converted into 2,801,000 shares of common stock.

On May 13, 2008 we entered into an underwriting agreement pursuant to which we sold 69,000,000 shares of our common stock for net proceeds following underwriting expenses of approximately $1.1 billion. This transaction settled on May 19, 2008.

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

During the year ended December 31, 2008, we raised $93.7 million by issuing 5.8 million shares through our Direct Purchase and Dividend Reinvestment Program.

On August 3, 2006, we entered into an ATM Equity Offering(sm) Sales Agreement with Merrill Lynch & Co. and Merrill Lynch, Pierce, Fenner & Smith Incorporated, relating to the sale of shares of our common stock from time to time through Merrill Lynch. Sales of the shares, if any, are made by means of ordinary brokers' transaction on the New York Stock Exchange. During the year ended December 31, 2008, 588,000 shares of our common stock were issued pursuant to this program, totaling $11.5 million in net proceeds.

On August 3, 2006, we entered into an ATM Equity Sales Agreement with UBS Securities LLC, relating to the sale of shares of our common stock from time to time through UBS Securities. Sales of the shares, if any, are made by means of ordinary brokers' transaction on the New York Stock Exchange. During the year ended December 31, 2008, 3.8 million shares of our common stock were issued pursuant to this program, totaling $60.3 million in net proceeds.

During the year ended December 31, 2008, 300,000 options were exercised under the Long-Term Stock Incentive Plan, or Incentive Plan, for an aggregate exercise price of $2.8 million.

Unrealized Gains and Losses

With our "available-for-sale" accounting treatment, unrealized fluctuations in market values of assets do not impact our GAAP or taxable income but rather are reflected on our statement of financial condition by changing the carrying value of the asset and stockholders' equity under "Accumulated Other Comprehensive Income (Loss)." As a result of the de-designation of interest rate swaps as cash flow hedges during the quarter ended December 31, 2008, unrealized gains and losses in our interest rate swaps impact our GAAP income.

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

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

Unrealized Gains and Losses
(dollars in thousands)

	March 31, 2009	December 31, 2008	September 30, 2008	June 30, 2008
Unrealized gain	$1,502,319	$785,087	$217,710	$324,612
Unrealized loss	(380,768)	(532,857)	(879,208)	(803,403)
Net Unrealized gain (loss)	$1,121,551	$252,230	($661,498)	($478,791)

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

Leverage

Our debt-to-equity ratio at March 31, 2009 and December 31, 2008 was 6.0:1 and 6.4:1, respectively. We generally expect to maintain a ratio of debt-to-equity of between 8:1 and 12:1, although the ratio may vary from this range from time to time based upon various factors, including our management's opinion of the level of risk of our assets and liabilities, our liquidity position, our level of unused borrowing capacity and over-collateralization levels required by lenders when we pledge assets to secure borrowings.

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

Asset/Liability Management and Effect of Changes in Interest Rates

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

We seek to manage the extent to which our net income changes as a function of changes in interest rates by matching adjustable-rate assets with variable-rate borrowings. In addition, we have attempted to mitigate the potential impact on net income of periodic and lifetime coupon adjustment restrictions in our portfolio of investment securities by entering into interest

rate swaps. At March 31, 2009, we had entered into swap agreements with a total notional amount of $17.3 billion. We agreed to pay a weighted average pay rate of 4.55% and receive a floating rate based on one month LIBOR. At December 31, 2008, we entered into swap agreements with a total notional amount of $17.6 billion. We agreed to pay a weighted average pay rate of 4.66% and receive a floating rate based on one month LIBOR. We may enter into similar derivative transactions in the future by entering into interest rate collars, caps or floors or purchasing interest only securities.

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

Off-Balance Sheet Arrangements

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

Capital Resources

At March 31, 2009, we had no material commitments for capital expenditures.

Inflation

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

Other Matters

We calculate that at least 75% of our assets were qualified REIT assets, as defined in the Code for the quarters ended March 31, 2009 and 2008. We also calculate that our revenue qualifies for the 75% source of income test and for the 95% source of income test rules for the quarters ended March 31, 2009 and 2008. Consequently, we met the REIT income and asset test. We also met all REIT requirements regarding the ownership of our common stock and the distribution of our net income. Therefore, as of March 31, 2009 and December 31, 2008, we believe that we qualified as a REIT under the Code.

We at all times intend to conduct our business so as not to become regulated as an investment company under the Investment Company Act of 1940, or the Investment Company Act. If we were to become regulated as an investment company, then our use of leverage would be substantially reduced. The Investment Company Act exempts entities that are "primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate" (qualifying interests). Under current interpretation of the staff of the SEC, in order to qualify for this exemption, we must maintain at least 55% of our assets directly in qualifying interests and at least 80% of our assets in qualifying interests plus other real estate related assets. In addition, unless certain mortgage securities represent all the certificates issued with respect to an underlying pool of mortgages, the Mortgage-Backed Securities may be treated as securities separate from the underlying mortgage loans and, thus, may not be considered qualifying interests for purposes of the 55% requirement. We calculate that as of March 31, 2009 and December 31, 2008, we were in compliance with this requirement.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

MARKET RISK

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

Our profitability and the value of our portfolio (including interest rate swaps) may be adversely affected during any period as a result of changing interest rates. The following table quantifies the potential changes in net interest income, portfolio value should interest rates go up or down 25, 50 and 75 basis points, assuming the yield curves of the rate shocks will be parallel to each other and the current yield curve. All changes in income and value are measured as percentage changes from the projected net interest income and portfolio value at the base interest rate scenario. The base interest rate scenario assumes interest rates at March 31, 2009 and various estimates regarding prepayment and all activities are made at each level of rate shock. Actual results could differ significantly from these estimates.

Change in Interest Rate	Projected Percentage Change in Net Interest Income	Projected Percentage Change in Portfolio Value, with Effect o[f] Interest Rate Swaps
-75 Basis Points	2.33%	1.75%
-50 Basis Points	1.15%	1.68%
-25 Basis Points	0.01%	1.51%
Base Interest Rate	-	-
+25 Basis Points	(1.58%)	0.86%
+50 Basis Points	(3.39%)	0.39%
+75 Basis Points	(5.20%)	(0.19%)

ASSET AND LIABILITY MANAGEMENT

Asset and liability management is concerned with the timing and magnitude of the repricing of assets and liabilities. We attempt to control risks associated with interest rate movements. Methods for evaluating interest rate risk include an analysis of our interest rate sensitivity "gap", which is the difference between interest-earning assets and interest-bearing liabilities maturing or repricing within a given time period. A gap is considered positive when the amount of interest-rate sensitive assets exceeds the amount of interest-rate sensitive liabilities. A gap is considered negative when the amount of interest-rate sensitive liabilities exceeds interest-rate sensitive assets. During a period of rising interest rates, a negative gap would tend to adversely affect net interest income, while a positive gap would tend to result in an increase in net interest income. During a period of falling interest rates, a negative gap would tend to result in an increase in net interest income, while a positive gap would tend to affect net interest income adversely. Because different types of assets and liabilities with the same or similar maturities may react differently to changes in overall market rates or conditions, changes in interest rates may affect net interest income positively or negatively even if an institution were perfectly matched in each maturity category.

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The following table sets forth the estimated maturity or repricing of our interest-earning assets and interest-bearing liabilities at March 31, 2009. 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 based on actual prepayment experience.

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

Rate Sensitive Assets:				
Investment Securities (Principal)	$5,385,767	$2,607,636	$3,486,223	$4
Cash Equivalents	1,035,118	-	-	
Reverse Repurchase Agreements	452,480	-	-	
Total Rate Sensitive Assets	6,873,365	2,607,636	3,486,223	4
Rate Sensitive Liabilities:				
Repurchase Agreements, with the effect of swaps	23,262,528	6,160,650	13,052,350	
Interest rate sensitivity gap	($16,389,163)	($3,553,014)	($9,566,127)	$3
Cumulative rate sensitivity gap	($16,389,163)	($19,942,177)	($29,508,304)	$
Cumulative interest rate sensitivity gap as a percentage of total rate-sensitive assets	(29%)	(35%)	(52%)	

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

ITEM 4. CONTROLS AND PROCEDURES

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

PART II. OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

From time to time, we are involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material 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, 2008, which could materially affect our business, financial condition or future results. The materialization of any risks and uncertainties identified in our forward looking statements contained in this report together with those previously disclosed in the Form 10-K or those that are presently unforeseen could result in significant adverse effects on our financial condition, results of operations and cash flows. See Item 2. "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Special Note Regarding Forward Looking Statements" in this quarterly report on Form 10-Q. The information presented below updates and should be read in conjunction with the risk factors and information disclosed in that Form 10-K.

The conservatorship of Fannie Mae and Freddie Mac and related efforts, along with any changes in laws and regulations affecting the relationship between Fannie Mae and Freddie Mac and the federal government, may adversely affect our business.

Due to increased market concerns about Fannie Mae and Freddie Mac's ability to withstand future credit losses associated with securities held in their investment portfolios, and on which they provide guarantees, without the direct support of the federal government, on July 30, 2008, the government passed the Housing and Economic Recovery Act of 2008, or the HERA. Among other things, the HERA established the Federal Housing Finance Agency, or FHFA, which has broad regulatory powers over Fannie Mae and Freddie Mac. On September 7, 2008, the FHFA placed Fannie Mae and Freddie Mac into conservatorship and, together with the Treasury, established a program designed to boost investor confidence in Fannie Mae's and Freddie Mac's debt and mortgage-backed securities. As the conservator of Fannie Mae and Freddie Mac, the FHFA controls and directs the operations of Fannie Mae and Freddie Mac and may (1) take over the assets of and operate Fannie Mae and Freddie Mac with all the powers of the shareholders, the directors and the officers of Fannie Mae and Freddie Mac and conduct all business of Fannie Mae and Freddie Mac; (2) collect all obligations and money due to Fannie Mae and Freddie Mac; (3) perform all functions of Fannie Mae and Freddie Mac which are consistent with the conservator's appointment; (4) preserve and conserve the assets and property of Fannie Mae and Freddie Mac; and (5) contract for assistance in fulfilling any function, activity, action or duty of the conservator. A primary focus of this new legislation is to increase the availability of mortgage financing by allowing Fannie Mae and Freddie Mac to continue to grow their guarantee business without limit, while limiting net purchases of agency mortgage-backed securities to a modest amount through the end of 2009. It is currently planned for Fannie Mae and Freddie Mac to reduce gradually their agency mortgage-backed securities portfolios beginning in 2010.

In addition to FHFA becoming the conservator of Fannie Mae and Freddie Mac, the Treasury has taken three additional actions: (i) the Treasury and FHFA have entered into preferred stock purchase agreements between the Treasury and Fannie Mae and Freddie Mac pursuant to which the Treasury will ensure that each of Fannie Mae and Freddie Mac maintains a positive net worth; (ii) the Treasury has established a new secured lending credit facility which will be available to Fannie Mae, Freddie Mac and the Federal Home Loan Banks, which is intended to serve as a liquidity backstop, which will be available until December 2009; and (iii) the Treasury has initiated a temporary program to purchase agency mortgage-backed securities issued by Fannie Mae and Freddie Mac.

Although the Treasury has committed capital to Fannie Mae and Freddie Mac, there can be no assurance that these actions will be adequate for their needs. If these actions are inadequate, Fannie Mae and Freddie Mac could continue to suffer losses and could fail to honor their guarantees and other obligations. The future roles of Fannie Mae and Freddie Mac could be significantly reduced and the nature of their guarantees could be considerably limited relative to historical measurements. Any changes to the nature of the guarantees provided by Fannie Mae and Freddie Mac could redefine what constitutes agency mortgage-backed securities and could have broad adverse market implications.

On November 25, 2008, the Federal Reserve announced that it will initiate a program to purchase $100 billion in direct obligations of Fannie Mae, Freddie Mac and the Federal Home Loan Banks and $500 billion in agency mortgage-backed securities backed by Fannie Mae, Freddie Mac and Ginnie Mae. The Federal Reserve stated that its actions are intended to reduce the cost and increase the availability of credit for the purchase of houses, and are meant to support housing markets and foster improved conditions in financial markets more generally. The purchases of direct obligations began during the first week of December 2008, and the purchases of agency mortgage-backed securities began in early January 2009. The Federal Reserve has announced an expansion of this program to purchase another $750 million in agency mortgage-backed securities through the end of 2009. The Federal Reserve's program to purchase agency mortgage-backed securities could cause an increase in the price of agency mortgage-backed securities, which could help the value of the assets in our portfolio but may negatively impact the net interest margin with respect to new agency mortgage-backed securities we may purchase.

The size and timing of the federal government's agency mortgage-backed securities purchase program is subject to the discretion of the Treasury and the Federal Reserve. Purchases under these programs have already begun, but there is no certainty that they will continue. It is possible that a change in the Treasury's and the Federal Reserve's commitment to purchase agency mortgage-backed securities in the future could negatively affect the pricing of agency mortgage-backed securities that we seek to acquire. Given the highly fluid and evolving nature of events, it is unclear how our business may be impacted. Further activity of the U.S. Government or market response to developments at Fannie Mae and Freddie Mac could adversely impact our business.

Mortgage loan modification programs, future legislative action and changes in the requirements necessary to qualify for refinancing a mortgage with Fannie Mae, Freddie Mac or Ginnie Mae may adversely affect the value of, and the returns on, the assets in which we invest.

During the second half of 2008 and in early 2009, the U.S. government, through the Federal Housing Administration, or FHA, and the FDIC, commenced implementation of programs designed to provide homeowners with assistance in avoiding residential mortgage loan foreclosures including the Hope for Homeowners Act of 2008, which allows certain distressed borrowers to refinance their mortgages into FHA-insured loans. The programs may also involve, among other things, the modification of mortgage loans to reduce the principal amount of the loans or the rate of interest payable on the loans, or to extend the payment terms of the loans. Members of the U.S. Congress have indicated support for additional legislative relief for homeowners, including an amendment of the bankruptcy laws to permit the modification of mortgage loans in bankruptcy proceedings. These loan modification programs, future legislative or regulatory actions, including amendments to the bankruptcy laws, that result in the modification of outstanding mortgage loans, as well as changes in the requirements necessary to qualify for refinancing a mortgage with Fannie Mae, Freddie Mac or Ginnie Mae may adversely affect the value of, and the returns on, our Investment Securities. Depending on whether or not we purchased an instrument at a premium or discount, the yield we receive may be positively or negatively impacted by any modification.

The actions of the U.S. government, Federal Reserve and Treasury, including the establishment of the TALF and the PPIP, may adversely affect our business.

The TALF was first announced by the Treasury on November 25, 2008, and has been expanded in size and scope since its initial announcement. Under the TALF, the Federal Reserve Bank of New York makes non-recourse loans to borrowers to fund their purchase of eligible assets, currently certain asset backed securities but not mortgage-backed securities. The nature of the eligible assets has been expanded several times. The Treasury has stated that through its expansion of the TALF, non-recourse loans will be made available to investors to certain fund purchases of legacy securitization assets. On March 23, 2009, the Treasury in conjunction with the FDIC, and the Federal Reserve, announced the PPIP. The PPIP aims to recreate a market for specific illiquid residential and commercial loans and securities through a number of joint public and private investment funds. The PPIP is designed to draw new private capital into the market for these securities and loans by providing government equity co-investment and attractive public financing.

These programs are still in early stages of development, and it is not possible to predict how the TALF, the PPIP, or other recent U.S. government actions will impact the financial markets, including current significant levels of volatility, or our current or future investments. To the extent the market does not respond favorably to these initiatives or they do not function as intended, our business may not receive any benefits from this legislation. In addition, the U.S. government, Federal Reserve, Treasury and other governmental and regulatory bodies have taken or are considering taking other actions to address the financial crisis. We cannot predict whether or when such actions may occur, and such actions could have a dramatic impact on our business, results of operations and financial condition.

Item 6. EXHIBITS

Exhibits:

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

EXHIBIT INDEX

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

3.2	Articles of Amendment of the Articles of Incorporation of the Registrant (incorporated by reference to Exhibit 3.1 of the Registrant's Registration Statement on Form S-3 (Registration Statement 333-74618) filed with the Securities and Exchange Commission on June 12, 2002).
3.3	Articles of Amendment of the Articles of Incorporation of the Registrant (incorporated by reference to Exhibit 3.1 of the Registrant's Form 8-K (filed with the Securities and Exchange Commission on August 3, 2006).
3.4	Articles of Amendment of the Articles of Incorporation of the Registrant (incorporated by reference to Exhibit 3.4 of the Registrant's Form 10-Q (filed with the Securities and Exchange Commission on May 7, 2008).
3.5	Form of Articles Supplementary designating the Registrant's 7.875% Series A Cumulative Redeemable Preferred Stock, liquidation preference $25.00 per share (incorporated by reference to Exhibit 3.3 to the Registrant's 8-A filed April 1, 2004).
3.6	Articles Supplementary of the Registrant's designating an additional 2,750,000 shares of the Company's 7.875% Series A Cumulative Redeemable Preferred Stock, as filed with the State Department of Assessments and Taxation of Maryland on October 15, 2004 (incorporated by reference to Exhibit 3.2 to the Registrant's 8-K filed October 4, 2004).
3.7	Articles Supplementary designating the Registrant's 6% Series B Cumulative Convertible Preferred Stock, liquidation preference $25.00 per share (incorporated by reference to Exhibit 3.1 to the Registrant's 8-K filed April 10, 2006).
3.8	Bylaws of the Registrant, as amended (incorporated by reference to Exhibit 3.3 to the Registrant's Registration Statement on Form S-11 (Registration No. 333-32913) filed with the Securities and Exchange Commission on August 5, 1997).
4.1	Specimen Common Stock Certificate (incorporated by reference to Exhibit 4.1 to Amendment No. 1 to the Registrant's Registration Statement on Form S-11 (Registration No. 333-32913) filed with the Securities and Exchange Commission on September 17, 1997).
4.2	Specimen Preferred Stock Certificate (incorporated by reference to Exhibit 4.2 to the Registrant's Registration Statement on Form S-3 (Registration No. 333-74618) filed with the Securities and Exchange Commission on December 5, 2001).
4.3	Specimen Series A Preferred Stock Certificate (incorporated by reference to Exhibit 4.1 of the Registrant's Registration Statement on Form 8-A filed with the SEC on April 1, 2004).
4.4	Specimen Series B Preferred Stock Certificate (incorporated by reference to Exhibit 4.1 to the Registrant's Form 8-K filed with the Securities and Exchange Commission on April 10, 2006).

31.1	Certification of Michael A.J. Farrell, Chairman, Chief Executive Officer, and President of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 302 of the Sarbanes-Oxley

Act of 2002.

31.2 Certification of Kathryn F. Fagan, Chief Financial Officer and Treasurer of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

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

32.2 Certification of Kathryn F. Fagan, Chief Financial Officer and Treasurer of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

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

ANNALY CAPITAL MANAGEMENT, INC.

Dated: May 7, 2009

By: /s/ Michael A.J. Farrell

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

Dated: May 7, 2009

By: /s/ Kathryn F. Fagan

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

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Options exercised
58

2,144

2,144

2,144

Restricted stock awards released
312

—

—

—

Issuance of stock-based compensation awards
21

955

955

955

Employee stock purchase plan
20

747

747

747

Stock-based compensation expense

17,080

17,080

17,080

Employee stock plans income tax deficiencies

2,870

2,870

2,870

Balances at December 31, 2016
38,317

1,270,467

(229,327
)

(409,536
)

631,604

18,749

650,353

Net income

57,298

57,298

2,951

60,249

Cumulative effect of accounting change (ASU 2016-09)

215

14,365

14,580

14,580

Other comprehensive income (loss), net of tax

58,849

58,849

—

58,849

Distributions to noncontrolling interests

(2,171
)

(2,171
)
Stock issues and repurchases:

Options exercised
41

1,631

1,631

1,631

Restricted stock awards released
372

—

—

—

Issuance of stock-based compensation awards
10

974

974

974

Employee stock purchase plan
31

1,978

1,978

1,978

Stock-based compensation expense

20,433

20,433

20,433

Repurchase of noncontrolling interest

(906
)

(906
)

(313
)

(1,219
)
Registration fee

(25
)

(25
)

(25
)
Balances at December 31, 2017
38,771

1,294,767

(170,478
)

(337,873
)

786,416

19,216

805,632

Net income (loss)

(99,250
)

(99,250
)

2,669

(96,581
)
Cumulative effect of accounting change (ASU 2014-09 and ASU 2016-16)

—

11,727

11,727

11,727

Other comprehensive income (loss), net of tax

(25,827
)

(25,827
)

—

(25,827
)
Distributions to noncontrolling interests

(500
)

(500
)
Stock issues and repurchases:

Options exercised
152

5,935

5,935

5,935

Restricted stock awards released
517

—

—

—

Issuance of stock-based compensation awards
10

729

729

729

Employee stock purchase plan
48

2,974

2,974

2,974

Stock-based compensation expense

30,534

30,534

30,534

Registration fee

(22
)

(22
)

(22
)
SSNI acquisition adjustments, net

(553
)

(553
)

(553
)
Balances at December 31, 2018
39,498

$
1,334,364

$
(196,305
)

$
(425,396
)

$
712,663

$
21,385

$
734,048

The accompanying notes are an integral part of these consolidated financial statements.

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ITRON, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	2018	2017	2016
	(in thousands)		
Operating activities			
Net income (loss)	$(96,581)	$60,249	$35,053
Adjustments to reconcile net (loss) income to net cash provided by operating activities:			
Depreciation and amortization	122,497	63,215	68,318
Stock-based compensation	31,263	21,407	18,035
Amortization of prepaid debt fees	7,046	1,067	1,076
Deferred taxes, net	(19,130)	50,667	13,790
Restructuring, non-cash	859	(2,297)	7,188
Other adjustments, net	1,452	3,673	4,309
Changes in operating assets and liabilities, net of acquisitions:			
Accounts receivable	15,524	(17,573)	(27,162)
Inventories	(25,613)	(16,242)	22,343
Other current assets	(23,589)	8,112	20,705
Other long-term assets	3,020	11,230	(339)
Accounts payables, other current liabilities, and taxes payable	20,101	78,463	(37,312)
Wages and benefits payable	(9,565)	1,926	7,808
Unearned revenue	27,584	(41,309)	(25,810)
Warranty	20,815	(10,554)	(10,246)
Other operating, net	34,072	(20,680)	18,086
Net cash provided by operating activities	109,755	191,354	115,842
Investing activities			
Acquisitions of property, plant, and equipment	(59,952)	(49,495)	(43,543)
Business acquisitions, net of cash equivalents acquired	(803,075)	(99,386)	(951)
Other investing, net	369	702	(3,034)
Net cash used in investing activities	(862,658)	(148,179)	(47,528)
Financing activities			
Proceeds from borrowings	778,938	335,000	15,877
Payments on debt	(363,359)	(29,063)	(79,119)
Issuance of common stock	9,171	3,609	2,891
Prepaid debt fees	(24,042)	—	—
Other financing, net	(4,887)	(7,587)	(2,672)
Net cash provided by (used in) financing activities	395,821	301,959	(63,023)
Effect of foreign exchange rate changes on cash, cash equivalents, and restricted cash	(7,925)	8,636	(2,744)
(Decrease) increase in cash, cash equivalents, and restricted cash	(365,007)	353,770	2,547
Cash, cash equivalents, and restricted cash at beginning of period	487,335	133,565	131,018
Cash, cash equivalents, and restricted cash at end of period	$122,328	$487,335	$133,565

Supplemental disclosure of cash flow information:			
Cash paid during the period for:			
Income taxes, net	$13,771	$28,969	$24,287
Interest	42,347	10,106	9,921

The accompanying notes are an integral part of these consolidated financial statements.

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ITRON, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2018

In this Annual Report, the terms "we," "us," "our," "Itron," and the "Company" refer to Itron, Inc.

Note 1: Summary of Significant Accounting Policies

We were incorporated in the state of Washington in 1977, and are a technology company, offering end-to-end solutions to enhance productivity and efficiency, primarily focused on utilities and municipalities around the globe. Our solutions generally include robust industrial grade networks, smart meters, meter data management software, and knowledge application solutions, which bring additional value to the customer. Our professional services help our customers project-manage, install, implement, operate, and maintain their systems. We operate under the Itron brand worldwide and manage and report under three operating segments: Device Solutions, Networked Solutions, and Outcomes.

Financial Statement Preparation
The consolidated financial statements presented in this Annual Report include the Consolidated Statements of Operations, Comprehensive Income (Loss), Equity, and Cash Flows for the years ended December 31, 2018, 2017, and 2016 and the Consolidated Balance Sheets as of December 31, 2018 and 2017 of Itron, Inc. and its subsidiaries, prepared in accordance with U.S. generally accepted accounting principles (GAAP).

On January 1, 2018, we adopted ASC 606 using the modified retrospective method applied to those contracts that were not completed. Results for reporting periods beginning after January 1, 2018 are presented under ASC 606, while prior period amounts are not adjusted and continue to be reported in accordance with our historic accounting under ASC 605, *Revenue Recognition* (ASC 605). The cumulative impact of adoption was a net decrease to accumulated deficit of $10.9 million as of January 1, 2018, with the impact primarily related to multiple element arrangements that contain software and software related elements. As we had not established vendor specific objective evidence of fair value for certain of our software and software related elements, we historically combined them as one unit of account and recognized the combined unit of account using the combined services approach. Under ASC 606, these software and software related elements are generally determined to be distinct performance obligations. As such, we are able to recognize revenue as we satisfy the performance obligations, either at a point in time or over time. For contracts that were modified prior to January 1, 2018, we have reflected the aggregate effect of all modifications prior to the date of initial adoption in order to identify the satisfied and unsatisfied performance obligations, determine the transaction price, and allocate the transaction price to satisfied and unsatisfied performance obligations.

Refer to the updated Revenue Recognition accounting policy described below and "Note 18: Revenues" for additional disclosures regarding our revenues from contracts with customers and the adoption of ASC 606.

Use of Estimates
The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Examples of significant estimates include revenue recognition, warranty, restructuring, income taxes, business combinations, goodwill and intangible assets, defined benefit pension plans, contingencies, and stock-based compensation. Due to various factors affecting future costs and operations, actual results could differ materially from these estimates.

Basis of Consolidation

We consolidate all entities in which we have a greater than 50% ownership interest or in which we exercise control over the operations. We use the equity method of accounting for entities in which we have a 50% or less investment and exercise significant influence. Entities in which we have less than a 20% investment and where we do not exercise significant influence are accounted for under the cost method. Intercompany transactions and balances are eliminated upon consolidation.

Noncontrolling Interests

In several of our consolidated international subsidiaries, we have joint venture partners, who are minority shareholders. Although these entities are not wholly-owned by Itron, we consolidate them because we have a greater than 50% ownership interest or because we exercise control over the operations. The noncontrolling interest balance is adjusted each period to reflect the allocation of net income (loss) and other comprehensive income (loss) attributable to the noncontrolling interests, as shown in our Consolidated Statements of Operations and our Consolidated Statements of Comprehensive Income (Loss) as well as contributions from and distributions to the owners. The noncontrolling interest balance in our Consolidated Balance Sheets represents the proportional share of the equity of the joint venture entities which is attributable to the minority shareholders.

Cash and Cash Equivalents
We consider all highly liquid instruments with remaining maturities of three months or less at the date of acquisition to be cash equivalents.

Restricted Cash and Cash Equivalents
Cash and cash equivalents that are contractually restricted from operating use are classified as restricted cash and cash equivalents. On December 22, 2017, we issued $300 million aggregate principal amount of 5.00% senior unsecured notes due in 2026 (Notes). The proceeds of the Notes plus prepaid interest and a premium for a special mandatory redemption option were deposited into escrow, where the funds remained until all the escrow release conditions were satisfied, specifically the closing of the acquisition of Silver Spring Networks, Inc. (SSNI) on January 5, 2018. We have recognized the balance in escrow as restricted cash in our consolidated financial statements as of December 31, 2017. See "Note 6: Debt" for further details.

The following table provides a reconciliation of cash, cash equivalents, and restricted cash reported within the Consolidated Balance Sheets that sum to the total of the same such amounts shown in the Consolidated Statements of Cash Flows:

	Year Ended December 31,		
	2018	**2017**	**2016**
	(in thousands)		
Cash and cash equivalents	$120,221	$176,274	$133,565
Current restricted cash included in other current assets	51	51	—
Long-term restricted cash	2,056	311,010	—
Total cash, cash equivalents, and restricted cash:	$122,328	$487,335	$133,565

Accounts Receivable, net
Accounts receivable are recognized for invoices issued to customers in accordance with our contractual arrangements. Interest and late payment fees are minimal. Unbilled receivables are recognized when revenues are recognized upon product shipment or service delivery and invoicing occurs at a later date. We recognize an allowance for doubtful accounts representing our estimate of the probable losses in accounts receivable at the date of the balance sheet based on our historical experience of bad debts and our specific review of outstanding receivables. Accounts receivable are written-off against the allowance when we believe an account, or a portion thereof, is no longer collectible.

Inventories
Inventories are stated at the lower of cost or net realizable value using the first-in, first-out method. Cost includes raw materials and labor, plus applied direct and indirect costs. Net realizable value is the estimated selling price in the normal course of business, minus the cost of completion, disposal and transportation.

Derivative Instruments
All derivative instruments, whether designated in hedging relationships or not, are recognized on the Consolidated Balance Sheets at fair value as either assets or liabilities. The components and fair values of our derivative instruments are determined using the fair value measurements of significant other observable inputs (Level 2), as defined by GAAP. The fair value of our derivative instruments may switch between an asset and a liability depending on market circumstances at the end of the period. We include the effect of our counterparty credit risk based on current published credit default swap rates when the net fair value of our derivative instruments are in a net asset position and the effect

of our own nonperformance risk when the net fair value of our derivative instruments are in a net liability position.

For any derivative designated as a fair value hedge, the changes in the fair value of the derivative and of the hedged item attributable to the hedged risk are recognized in earnings. For any derivative designated as a cash flow hedge, the effective portions of changes in the fair value of the derivative are recognized as a component of other comprehensive income (loss) (OCI) and are recognized in earnings when the hedged item affects earnings. For a hedge of a net investment, the effective portion of any unrealized gain or loss from the foreign currency revaluation of the hedging instrument is reported in OCI as a net unrealized gain or loss on derivative instruments. Upon termination of a net investment hedge, the net derivative gain/loss will remain in accumulated other comprehensive income (loss) (AOCI) until such time when earnings are impacted by a sale or liquidation of the associated operations. We classify cash flows from our derivative programs as cash flows from operating activities in the Consolidated Statements of Cash Flows.

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Derivatives are not used for trading or speculative purposes. Our derivatives are with credit worthy multinational commercial banks, with whom we have master netting agreements; however, our derivative positions are not recognized on a net basis in the Consolidated Balance Sheets. There are no credit-risk-related contingent features within our derivative instruments. Refer to "Note 7: Derivative Financial Instruments" and "Note 14: Shareholders' Equity" for further disclosures of our derivative instruments and their impact on OCI.

Property, Plant, and Equipment

Property, plant, and equipment are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 30 years for buildings and improvements and three years to ten years for machinery and equipment, computers and software, and furniture. Leasehold improvements are capitalized and depreciated over the term of the applicable lease, including renewable periods if reasonably assured, or over the useful lives, whichever is shorter. Construction in process represents capital expenditures incurred for assets not yet placed in service. Costs related to internally developed software and software purchased for internal uses are capitalized and are amortized over the estimated useful lives of the assets. Repair and maintenance costs are recognized as incurred. We have no major planned maintenance activities.

We review long-lived assets for impairment whenever events or circumstances indicate the carrying amount of an asset group may not be recoverable. Assets held for sale are classified within other current assets in the Consolidated Balance Sheets, are reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. Gains and losses from asset disposals and impairment losses are classified within the Consolidated Statements of Operations according to the use of the asset, except those gains and losses recognized in conjunction with our restructuring activities, which are classified within restructuring expense.

Prepaid Debt Fees

Prepaid debt fees for term debt represent the capitalized direct costs incurred related to the issuance of debt and are recognized as a direct deduction from the carrying amount of the corresponding debt liability. We have elected to present prepaid debt fees for revolving debt within other long-term assets in the Consolidated Balance Sheets. These costs are amortized to interest expense over the terms of the respective borrowings, including contingent maturity or call features, using the effective interest method, or straight-line method when associated with a revolving credit facility. When debt is repaid early, the related portion of unamortized prepaid debt fees is written off and included in interest expense.

Business Combinations

On the date of acquisition, the assets acquired, liabilities assumed, and any noncontrolling interests in the acquiree are recognized at their fair values. The acquiree's results of operations are also included as of the date of acquisition in our consolidated results. Intangible assets that arise from contractual/legal rights, or are capable of being separated, as well as in-process research and development (IPR&D), are measured and recognized at fair value, and amortized over the estimated useful life. IPR&D is not amortized until such time as the associated development projects are completed or terminated. If a development project is completed, the IPR&D is reclassified as a core technology intangible asset and amortized over its estimated useful life. If the development project is terminated, the recognized value of the associated IPR&D is immediately recognized. If practicable, assets acquired and liabilities assumed arising from contingencies are measured and recognized at fair value. If not practicable, such assets and liabilities are measured and recognized when it is probable that a gain or loss has occurred, and the amount can be reasonably estimated. The residual balance of the purchase price, after fair value allocations to all identified assets and liabilities, represents goodwill. Acquisition-related costs are recognized as incurred. Integration costs associated with an acquisition are generally recognized in periods subsequent to the acquisition date, and changes in deferred tax asset valuation allowances and acquired income tax uncertainties, including penalties and interest, after the measurement period are recognized as a component of the provision for income taxes. Our acquisitions may include contingent consideration, which require us to recognize the fair value of the estimated liability at the time of the acquisition.

Subsequent changes in the estimate of the amount to be paid under the contingent consideration arrangement are recognized in the Consolidated Statements of Operations.

We estimate the preliminary fair value of acquired assets and liabilities as of the date of acquisition based on information available at that time utilizing either a cost or income approach. The determination of the fair value is judgmental in nature and involves the use of significant estimates and assumptions. Contingent consideration is recognized at fair value as of the date of the acquisition with adjustments occurring after the purchase price allocation period, which could be up to one year, recognized in earnings. Changes to valuation allowances on acquired deferred tax assets that occur after the acquisition date are recognized in the provision for, or benefit from, income taxes. The valuation of these tangible and identifiable intangible assets and liabilities is subject to further management review and may change materially between the preliminary allocation and end of the purchase price allocation period. Any changes in these estimates may have a material effect on our consolidated operating results or financial position.

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Goodwill and Intangible Assets

Goodwill and intangible assets may result from our business acquisitions. Intangible assets may also result from the purchase of assets and intellectual property in a transaction that does not qualify as a business combination. We use estimates, including estimates of useful lives of intangible assets, the amount and timing of related future cash flows, and fair values of the related operations, in determining the value assigned to goodwill and intangible assets. Our finite-lived intangible assets are amortized over their estimated useful lives based on estimated discounted cash flows, generally three years to ten years for core-developed technology and customer contracts and relationships. Finite-lived intangible assets are tested for impairment at the asset group level when events or changes in circumstances indicate the carrying value may not be recoverable. Indefinite-lived intangible assets are tested for impairment annually, when events or changes in circumstances indicate the asset may be impaired, or at the time when their useful lives are determined to be no longer indefinite.

Goodwill is assigned to our reporting units based on the expected benefit from the synergies arising from each business combination, determined by using certain financial metrics, including the forecasted discounted cash flows associated with each reporting unit. Each reporting unit corresponds with its respective operating segment. We test goodwill for impairment each year as of October 1, or more frequently should a significant impairment indicator occur. As part of the impairment test, we may elect to perform an assessment of qualitative factors. If this qualitative assessment indicates that it is more likely than not that the fair value of a reporting unit, including goodwill, is less than its carrying amount, or if we elect to bypass the qualitative assessment, we would then proceed with the quantitative impairment test. The impairment test involves comparing the fair values of the reporting units to their carrying amounts. If the carrying amount of the reporting unit's goodwill exceeds the fair value of the reporting unit, an impairment loss is recognized in an amount equal to the excess.

Determining the fair value of a reporting unit is judgmental in nature and involves the use of significant estimates and assumptions. We forecast discounted future cash flows at the reporting unit level using risk-adjusted discount rates and estimated future revenues and operating costs, which take into consideration factors such as existing backlog, expected future orders, supplier contracts, and expectations of competitive and economic environments. We also identify similar publicly traded companies and develop a correlation, referred to as a multiple, to apply to the operating results of the reporting units. These combined fair values are then reconciled to the aggregate market value of our common stock on the date of valuation, while considering a reasonable control premium.

Contingencies

A loss contingency is recognized if it is probable that an asset has been impaired, or a liability has been incurred, and the amount of the loss can be reasonably estimated. We evaluate, among other factors, the degree of probability of an unfavorable outcome and our ability to make a reasonable estimate of the amount of the ultimate loss. Loss contingencies that we determine to be reasonably possible, but not probable, are disclosed but not recognized. Changes in these factors and related estimates could materially affect our financial position and results of operations. Legal costs to defend against contingent liabilities are recognized as incurred.

Bonus and Profit Sharing

We have various employee bonus and profit sharing plans, which provide award amounts for the achievement of financial and nonfinancial targets. If management determines it is probable that the targets will be achieved, and the amounts can be reasonably estimated, a compensation accrual is recognized based on the proportional achievement of the financial and nonfinancial targets. Although we monitor and accrue expenses quarterly based on our progress toward the achievement of the targets, the actual results may result in awards that are significantly greater or less than the estimates made in earlier quarters.

Warranty

We offer standard warranties on our hardware products and large application software products. We accrue the estimated cost of new product warranties based on historical and projected product performance trends and costs during the warranty period. Testing of new products in the development stage helps identify and correct potential warranty issues prior to manufacturing. Quality control efforts during manufacturing reduce our exposure to warranty claims. When testing or quality control efforts fail to detect a fault in one of our products, we may experience an increase in warranty claims. We track warranty claims to identify potential warranty trends. If an unusual trend is noted, an additional warranty accrual would be recognized if a failure event is probable and the cost can be reasonably estimated. When new products are introduced, our process relies on historical averages of similar products until sufficient data is available. As actual experience on new products becomes available, it is used to modify the historical averages to ensure the expected warranty costs are within a range of likely outcomes. Management regularly evaluates the sufficiency of the warranty provisions and makes adjustments when necessary. The warranty allowances may fluctuate due to changes in estimates for material, labor, and other costs we may incur to repair or replace projected product failures, and we may incur additional warranty and related expenses in the future with respect to new or established products, which could adversely affect our financial position and results of operations. The long-term warranty balance includes estimated warranty claims beyond one year. Warranty expense is classified within cost of revenues.

Restructuring
We recognize a liability for costs associated with an exit or disposal activity under a restructuring project in the period in which the liability is incurred. Employee termination benefits considered postemployment benefits are accrued when the obligation is probable and estimable, such as benefits stipulated by human resource policies and practices or statutory requirements. One-time termination benefits are recognized at the date the employee is notified. If the employee must provide future service greater than 60 days, such benefits are recognized ratably over the future service period. For contract termination costs, we recognize a liability upon the termination of a contract in accordance with the contract terms or the cessation of the use of the rights conveyed by the contract, whichever occurs later.

Asset impairments associated with a restructuring project are determined at the asset group level. An impairment may be recognized for assets that are to be abandoned, are to be sold for less than net book value, or are held for sale in which the estimated proceeds less costs to sell are less than the net book value. We may also recognize impairment on an asset group, which is held and used, when the carrying value is not recoverable and exceeds the asset group's fair value. If an asset group is considered a business, a portion of our goodwill balance is allocated to it based on relative fair value. If the sale of an asset group under a restructuring project results in proceeds that exceed the net book value of the asset group, the resulting gain is recognized within restructuring expense in the Consolidated Statements of Operations.

Defined Benefit Pension Plans
We sponsor both funded and unfunded defined benefit pension plans for certain international employees. We recognize a liability for the projected benefit obligation in excess of plan assets or an asset for plan assets in excess of the projected benefit obligation. We also recognize the funded status of our defined benefit pension plans on our Consolidated Balance Sheets and recognize as a component of OCI, net of tax, the actuarial gains or losses and prior service costs or credits, if any, that arise during the period but that are not recognized as components of net periodic benefit cost. If actuarial gains and losses exceed ten percent of the greater of plan assets or plan liabilities, we amortize them over the employees' average future service period.

Share Repurchase Plan
From time to time, we may repurchase shares of Itron common stock under programs authorized by our Board of Directors. Share repurchases are made in the open market or in privately negotiated transactions and in accordance with applicable securities laws. Under applicable Washington State law, shares repurchased are retired and not displayed separately as treasury stock on the financial statements; the value of the repurchased shares is deducted from common stock.

Product Revenues and Service Revenues
Product revenues include sales from standard and smart meters, systems or software, and any associated implementation and installation revenue. Service revenues include sales from post-sale maintenance support, consulting, outsourcing, and managed services.

Revenue Recognition - ASC 606 (for 2018 results in Consolidated Statements of Operations)
The majority of our revenues consist primarily of hardware sales, but may also include the license of software, software implementation services, cloud services and software-as-a-service (SaaS), project management services, installation services, consulting services, post-sale maintenance support, and extended or noncustomary warranties. We account for a contract when it has approval and commitment from both parties, the rights of the parties are identified, payment terms are identified, the contract has commercial substance, and collectability of consideration is probable. In determining whether the definition of a contract has been met, we will consider whether the arrangement creates enforceable rights and obligations, which involves evaluation of agreement terms that would allow for the customer to terminate the agreement. If the customer has the unilateral right to terminate the agreement without

providing further consideration to us, the agreement would not be considered to meet the definition of a contract.

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Many of our revenue arrangements involve multiple performance obligations consisting of hardware, meter reading system software, installation, and/or project management services. Separate contracts entered into with the same customer (or related parties of the customer) at or near the same time are accounted for as a single contract where one or more of the following criteria are met:

- The contracts are negotiated as a package with a single commercial objective;
- The amount of consideration to be paid in one contract depends on the price or performance of the other contract; or
- The goods or services promised in the contracts (or some goods or services promised in each of the contracts) are a single performance obligation.

Once the contract has been defined, we evaluate whether the promises in the contract should be accounted for as more than one performance obligation. This evaluation requires significant judgment, and the decision to separate the combined or single contract into multiple performance obligations could change the amount of revenue and profit recognized in a given period. For some of our contracts, the customer contracts with us to provide a significant service of integrating, customizing or modifying goods or services in the contract in which case the goods or services would be combined into a single performance obligation. It is common that we may promise to provide multiple distinct goods or services within a contract in which case we separate the contract into more than one performance obligation. If a contract is separated into more than one performance obligation, we allocate the total transaction price to each performance obligation in an amount based on the estimated relative standalone selling prices of the promised goods or services underlying each performance obligation. If applicable, for goods or services where we have observable standalone sales, the observable standalone sales are used to determine the standalone selling price. For the majority of our goods and services, we do not have observable standalone sales. As a result, we estimate the standalone selling price using either the adjusted market assessment approach or the expected cost plus a margin approach. Approaches used to estimate the standalone selling price for a given good or service will maximize the use of observable inputs and considers several factors, including our pricing practices, costs to provide a good or service, the type of good or service, and availability of other transactional data, among others.

We determine the estimated standalone selling prices of goods or services used in our allocation of arrangement consideration on an annual basis or more frequently if there is a significant change in our business or if we experience significant variances in our transaction prices.

Many of our contracts with customers include variable consideration, which can include liquidated damage provisions, rebates and volume and early payment discounts. Some of our contracts with customers contain clauses for liquidated damages related to the timing of delivery or milestone accomplishments, which could become material in an event of failure to meet the contractual deadlines. At the inception of the arrangement and on an ongoing basis, we evaluate the probability and magnitude of having to pay liquidated damages. We estimate variable consideration using the expected value method, taking into consideration contract terms, historical customer behavior and historical sales. In the case of liquidated damages, we also take into consideration progress towards meeting contractual milestones, including whether milestones have not been achieved, specified rates, if applicable, stated in the contract, and history of paying liquidated damages to the customer or similar customers. Variable consideration is included in the transaction price if, in our judgment, it is probable that a significant future reversal of cumulative revenue under the contract will not occur.

In the normal course of business, we do not accept product returns unless the item is defective as manufactured. We establish provisions for estimated returns and warranties. In addition, we do not typically provide customers with the right to a refund.

Hardware revenue is recognized at a point in time. Transfer of control is typically at the time of shipment, receipt by the customer, or, if applicable, upon receipt of customer acceptance provisions. We will recognize revenue prior to receipt of customer acceptance for hardware in cases where the customer acceptance provision is determined to be a formality. Transfer of control would not occur until receipt of customer acceptance in hardware arrangements where such provisions are subjective or where we do not have history of meeting the acceptance criteria.

Perpetual software licenses are considered to be a right to use intellectual property and are recognized at a point in time. Transfer of control is considered to be at the point at which it is available to the customer to download and use or upon receipt of customer acceptance. In certain contracts, software licenses may be sold with professional services that include implementation services that include a significant service of integrating, customizing or modifying the software. In these instances, the software license is combined into single performance obligation with the implementation services and recognized over time as the implementation services are performed.

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Hardware and software licenses (when not combined with professional services) are typically billed when shipped and revenue recognized at a point-in-time. As a result, the timing of revenue recognition and invoicing does not have a significant impact on contract assets and liabilities.

Professional services, which include implementation, project management, installation, and consulting services are recognized over time. We measure progress towards satisfying these performance obligations using input methods, most commonly based on the costs incurred in relation to the total expected costs to provide the service. We expect this method to best depict our performance in transferring control of services promised to the customer or represents a reasonable proxy for measuring progress. The estimate of expected costs to provide services requires judgment. Cost estimates take into consideration past history and the specific scope requested by the customer and are updated quarterly. We may also offer professional services on a stand-ready basis over a specified period of time, in which case revenue would be recognized ratably over the term. Invoicing of these services is commensurate with performance and occurs on a monthly basis. As such, these services do not have a significant impact on contract assets and contract liabilities.

Cloud services and SaaS arrangements where customers have access to certain of our software within a cloud-based IT environment that we manage, host and support are offered to customers on a subscription basis. Revenue for the cloud services and SaaS offerings are generally recognized over time, ratably over the contact term commencing with the date the services are made available to the customer.

Services, including professional services, cloud services and SaaS arrangements, are commonly billed on a monthly basis in arrears and typically result in an unbilled receivable, which is not considered a contract asset as our right to consideration is unconditional.

Certain of our revenue arrangements include an extended or noncustomary warranty provisions that covers all or a portion of a customer's replacement or repair costs beyond the standard or customary warranty period. Whether or not the extended warranty is separately priced in the arrangement, such warranties are considered to be a separate good or service, and a portion of the transaction price is allocated to this extended warranty performance obligation. This revenue is recognized, ratably over the extended warranty coverage period.

Hardware and software post-sale maintenance support fees are recognized over time, ratably over the life of the related service contract. Support fees are typically billed on an annual basis, resulting in a contract liability. Shipping and handling costs and incidental expenses billed to customers are recognized as revenue, with the associated cost charged to cost of revenues. We recognize sales, use, and value added taxes billed to our customers on a net basis.

Payment terms with customers can vary by customer; however, amounts billed are typically payable within 30 to 90 days, depending on the destination country. We do not make a practice of offering financing as part of our contracts with customers.

We incur certain incremental costs to obtain contracts with customers, primarily in the form of sales commissions. Where the amortization period is one year or less, we have elected to apply the practical expedient and recognize the related commissions expense as incurred. Otherwise, such incremental costs are capitalized and amortized over the contract period. Capitalized incremental costs are not material.

Revenue Recognition - ASC 605 (for 2016 and 2017 results in Consolidated Statements of Operations)
Revenues consist primarily of hardware sales, software license fees, software implementation, project management services, installation, consulting, and post-sale maintenance support. Revenues are recognized when (1) persuasive evidence of an arrangement exists, (2) delivery has occurred or services have been rendered, (3) the sales price is fixed or determinable, and (4) collectability is reasonably assured.

Many of our revenue arrangements involve multiple deliverables, which combine two or more of the following: hardware, meter reading system software, installation, and/or project management services. Separate contracts entered into with the same customer that meet certain criteria such as those that are entered into at or near the same time are evaluated as one single arrangement for purposes of applying multiple element arrangement revenue recognition. Revenue arrangements with multiple deliverables are divided into separate units of accounting at the inception of the arrangement and as each item in the arrangement is delivered. If the delivered item(s) has value to the customer on a standalone basis and delivery/performance of the undelivered item(s) is probable the total arrangement consideration is allocated among the separate units of accounting based on their relative fair values and the applicable revenue recognition criteria are then considered for each unit of accounting. The amount allocable to a delivered item is limited to the amount that we are entitled to collect and that is not contingent upon the delivery/performance of additional items. Revenues for each deliverable are then recognized based on the type of deliverable, such as (1) when the products are shipped, (2) services are delivered, (3) percentage-of-completion for implementation services, (4) upon receipt of customer acceptance, or 5) transfer of title and risk of loss. The majority of our revenue is recognized when products are shipped to or received by a customer or when services are provided.

Hardware revenues are generally recognized at the time of shipment, receipt by the customer, or, if applicable, upon completion of customer acceptance provisions.

Under contract accounting where revenue is recognized using percentage of completion, the cost to cost method is used to measure progress to completion. Revenue from OpenWay network software and services are recognized using the units-of-delivery method of contract accounting, as network design services and network software are essential to the functionality of the related hardware (network) for certain contracts. This methodology results in the deferral of costs and revenues as professional services and software implementation commence prior to deployment of hardware.

In the unusual instances when we are unable to reliably estimate the cost to complete a contract at its inception, we use the completed contract method of contract accounting. Revenues and costs are recognized upon substantial completion when remaining costs are insignificant and potential risks are minimal.

Change orders and contract modifications entered into after inception of the original contract are analyzed to determine if change orders or modifications are extensions of an existing agreement or are accounted for as a separate arrangement for purposes of applying contract accounting.

If we estimate that the completion of a contract component (unit of accounting) will result in a loss, the loss is recognized in the period in which the loss becomes evident. We reevaluate the estimated loss through the completion of the contract component and adjust the estimated loss for changes in facts and circumstances.

A few of our larger customer arrangements contain clauses for liquidated damages, related to delays in delivery or milestone accomplishments, which could become material in an event of failure to meet the contractual deadlines. At the inception of the arrangement and on an ongoing basis, we evaluate if the liquidated damages represent contingent revenue and, if so, we reduce the amount of consideration allocated to the delivered products and services and recognize it as a reduction in revenue in the period of default. If the arrangement is subject to contract accounting, liquidated damages resulting from failure or expected failure to meet milestones are estimated and are accounted for as a reduction of revenue in the period in which the liquidated damages are deemed probable of occurrence and are reasonably estimable.

Our software customers often purchase a combination of software, software-related services, and post contract customer support (PCS). PCS includes telephone support services and updates or upgrades for software as part of a maintenance program. For these types of arrangements, revenue recognition is dependent upon the availability of vendor specific objective evidence (VSOE) of fair value for any undelivered element. We determine VSOE by reference to the range of comparable standalone sales or stated renewals. We review these standalone sales or renewals on at least an annual basis. If VSOE is established for all undelivered elements in the contract, revenue is recognized for delivered elements when all other revenue recognition criteria are met. Arrangements in which VSOE for all undelivered elements is not established, we recognize revenue under the combined services approach where revenue for software and software related elements is deferred until all software products have been delivered, all software related services have commenced, and undelivered services do not include significant production, customization or modification. This will also result in the deferral of costs for software and software implementation services until the undelivered element commence. Revenue would be recognized over the longest period that services would be provided, which is typically the PCS period.

Cloud services and SaaS arrangements where customers have access to certain of our software within a cloud-based IT environment that we manage, host and support are offered to customers on a subscription basis. Revenue for the cloud services and SaaS offerings are generally recognized ratably over the contact term commencing with the date the services is made available to customers and all other revenue recognition criteria have been satisfied. For arrangements where cloud services and SaaS is provided on a per meter basis, revenue is recognized based on actual meters read during the period.

Certain of our revenue arrangements include an extended or noncustomary warranty provision that covers all or a portion of a customer's replacement or repair costs beyond the standard or customary warranty period. Whether or not the extended warranty is separately priced in the arrangement, a portion of the arrangement's total consideration is allocated to this extended warranty deliverable. This revenue is deferred and recognized over the extended warranty coverage period. Extended or noncustomary warranties do not represent a significant portion of our revenue.

We allocate consideration to each deliverable in an arrangement based on its relative selling price. We determine selling price using VSOE, if it exists, otherwise we use third-party evidence (TPE). We define VSOE as a median price of recent standalone

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transactions that are priced within a narrow range. TPE is determined based on the prices charged by our competitors for a similar deliverable when sold separately. If neither VSOE nor TPE of selling price exists for a unit of accounting, we use estimated selling price (ESP) to determine the price at which we would transact if the product or service were regularly sold by us on a standalone basis. Our determination of ESP involves a weighting of several factors based on the specific facts and circumstances of the arrangement. The factors considered include historical contractual sales, market conditions and entity specific factors, the cost to produce the deliverable, the anticipated margin on that deliverable, our ongoing pricing strategy and policies, and the characteristics of the varying markets in which the deliverable is sold.

We analyze the selling prices used in our allocation of arrangement consideration on an annual basis. Selling prices are analyzed on a more frequent basis if a significant change in our business necessitates a more timely analysis or if we experience significant variances in our selling prices.

Unearned revenue is recognized when a customer pays for products or services, but the criteria for revenue recognition have not been met as of the balance sheet date. Unearned revenue of $77.0 million and $114.3 million at December 31, 2017 and 2016 related primarily to professional services and software associated with our smart metering contracts, extended or noncustomary warranty, and prepaid post-contract support. Deferred costs are recognized for products or services for which ownership (typically defined as title and risk of loss) has transferred to the customer, but the criteria for revenue recognition have not been met as of the balance sheet date. Deferred costs were $14.4 million and $34.4 million at December 31, 2017 and 2016 and are recognized within other assets in the Consolidated Balance Sheets.

Hardware and software post-sale maintenance support fees, such as post contract support or extended warranty are recognized ratably over the life of the related service contract. Shipping and handling costs and incidental expenses billed to customers are recognized as revenue, with the associated cost charged to cost of revenues. We recognize sales, use, and value added taxes billed to our customers on a net basis.

Product and Software Development Costs
Product and software development costs primarily include employee compensation and third-party contracting fees. We do not capitalize product development costs, and we do not generally capitalize development expenses for computer software to be sold, leased, or otherwise marketed as the costs incurred are immaterial for the relatively short period of time between technological feasibility and the completion of software development.

Stock-Based Compensation
We grant various stock-based compensation awards to our officers, employees and Board of Directors with service, performance, and market vesting conditions, including stock options, restricted stock units, phantom stock units, and unrestricted stock units (awards). We measure and recognize compensation expense for all awards based on estimated fair values. For awards with only a service condition, we expense stock-based compensation using the straight-line method over the requisite service period for the entire award. For awards with service and performance conditions, if vesting is probable, we expense the stock-based compensation on a straight-line basis over the requisite service period for each separately vesting portion of the award. For awards with a market condition, we expense the fair value over the requisite service period. We have elected to account for forfeitures of any awards in stock-based compensation expense prospectively as they occur.

The fair value of stock options is estimated at the date of grant using the Black-Scholes option-pricing model. Options to purchase our common stock are granted with an exercise price equal to the market close price of the stock on the date the Board of Directors approves the grant. Options generally become exercisable in three equal annual installments beginning one year from the date of grant and expire 10 years from the date of grant. Expected volatility is based on a combination of the historical volatility of our common stock and the implied volatility of our traded options for the related expected term. We believe this combined approach is reflective of current and historical market conditions and is an appropriate indicator of expected volatility. The risk-free interest rate is the rate available as of the award date on zero-coupon U.S. government issues with a term equal to the expected term of the award. The expected term is the weighted average expected term of an award based on the period of time between the date the award is granted and the estimated date the award will be fully exercised. Factors considered in estimating the expected term include historical experience of similar awards, contractual terms, vesting schedules, and expectations of future employee behavior. We have not paid dividends in the past and do not plan to pay dividends in the foreseeable future.

The fair value of a restricted stock unit is the market close price of our common stock on the date of grant. Restricted stock units vest over a maximum period of three years. After vesting, the restricted stock units are converted into shares of our common stock on a one-for-one basis and issued to employees. Certain restricted stock units are issued under the Long-Term Performance Restricted Stock Unit Award Agreement and include performance and market conditions. The final number of shares issued will be based on the achievement of financial targets and our total shareholder return relative to the Russell 3000 Index during the performance periods. Due to the presence of a market condition, we utilize a Monte Carlo valuation model to determine the fair

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value of the awards at the grant date. Expected volatility is based on the historical volatility of our common stock for the related expected term. We believe this approach is reflective of current and historical market conditions and is an appropriate indicator of expected volatility. The risk-free interest rate is the rate available as of the award date on zero-coupon U.S. government issues with a term equal to the expected term of the award. The expected term is the term of an award based on the period of time between the date of the award and the date the award is expected to vest. The expected term assumption is based upon the plan's performance period as of the date of the award. We have not paid dividends in the past and do not plan to pay dividends in the foreseeable future.

Phantom stock units are a form of share-based award that are indexed to our stock price and are settled in cash upon vesting and accounted for as liability-based awards. Fair value is remeasured at the end of each reporting period based on the market close price of our common stock. Phantom stock units vest over a maximum period of three years. Since phantom stock units are settled in cash, compensation expense recognized over the vesting period will vary based on changes in fair value.

The fair value of unrestricted stock awards is the market close price of our common stock on the date of grant, and awards are fully vested. We expense stock-based compensation at the date of grant for unrestricted stock awards.

Excess tax benefits and deficiencies resulting from employee share-based payment are recognized as income tax provision or benefit in the Consolidated Statements of Operations, and as an operating activity on the Consolidated Statements of Cash Flows.

We also maintain an Employee Stock Purchase Plan (ESPP) for our employees. Under the terms of the ESPP, employees can deduct up to 10% of their regular cash compensation to purchase our common stock at a 5% discount from the fair market value of the stock at the end of each fiscal quarter, subject to other limitations under the plan. The sale of the stock to the employees occurs at the beginning of the subsequent quarter. The ESPP is not considered compensatory, and no compensation expense is recognized for sales of our common stock to employees.

Income Taxes
We account for income taxes using the asset and liability method of accounting. Deferred tax assets and liabilities are recognized based upon anticipated future tax consequences, in each of the jurisdictions that we operate, attributable to: (1) the differences between the financial statement carrying amounts of existing assets and liabilities and their respective income tax bases; and (2) net operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured annually using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The calculation of our tax liabilities involves applying complex tax regulations in different tax jurisdictions to our tax positions. The effect on deferred tax assets and liabilities of a change in tax legislation and/or rates is recognized in the period that includes the enactment date. A valuation allowance is recognized to reduce the carrying amounts of deferred tax assets if it is not more likely than not that such assets will be realized. We do not recognize tax liabilities on undistributed earnings of international subsidiaries that are permanently reinvested.

Foreign Exchange
Our consolidated financial statements are reported in U.S. dollars. Assets and liabilities of international subsidiaries with non-U.S. dollar functional currencies are translated to U.S. dollars at the exchange rates in effect on the balance sheet date, or the last business day of the period, if applicable. Revenues and expenses for each subsidiary are translated to U.S. dollars using a weighted average rate for the relevant reporting period. Translation adjustments resulting from this process are included, net of tax, in OCI. Gains and losses that arise from exchange rate fluctuations for monetary asset and liability balances that are not denominated in an entity's functional currency are included within other income (expense), net in the Consolidated Statements of Operations. Currency gains and losses of intercompany balances deemed to be long-term in nature or designated as a hedge of the net investment in

international subsidiaries are included, net of tax, in OCI. Foreign currency losses, net of hedging, of $3.0 million, $5.1 million, and $0.3 million were included in other expenses, net, for the years ended December 31, 2018, 2017 and 2016, respectively.

Fair Value Measurements

For assets and liabilities measured at fair value, the GAAP fair value hierarchy prioritizes the inputs used in different valuation methodologies, assigning the highest priority to unadjusted quoted prices for identical assets and liabilities in actively traded markets (Level 1) and the lowest priority to unobservable inputs (Level 3). Level 2 inputs consist of quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in non-active markets; and model-derived valuations in which significant inputs are corroborated by observable market data either directly or indirectly through correlation or other means. Inputs may include yield curves, volatility, credit risks, and default rates.

New Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-02, *Leases (Topic 842)* (ASU 2016-02), which requires substantially all leases be recognized by lessees on their balance sheet as a right-of-use asset and corresponding lease liability, including leases currently accounted for as operating leases. The new standard also will result in enhanced quantitative and qualitative disclosures, including significant judgments made by management, to provide greater insight into the extent of revenue and expense recognized and expected to be recognized from existing leases. The standard requires modified retrospective adoption and will be effective for annual reporting periods beginning after December 15, 2018, with early adoption permitted. In July 2018, the FASB issued ASU 2018-10, *Codification Improvements to Topic 842, Leases* (ASU 2018-10), to clarify, improve, and correct various aspects of ASU 2016-02, and also issued ASU 2018-11, *Targeted Improvements to Topic 842, Leases* (ASU 2018-11), to simplify transition requirements and, for lessors, provide a practical expedient for the separation of nonlease components from lease components. The effective date and transition requirements in ASU 2018-10 and ASU 2018-11 are the same as the effective date and transition requirements of ASU 2016-02. We currently believe the most significant impact relates to our real estate leases and the increased financial statement disclosures, with an increase to both total assets and total liabilities between $65 million and $85 million.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments - Credit Losses (Topic 326)* (ASU 2016-13), which replaces the incurred loss impairment methodology in current GAAP with a methodology based on expected credit losses. This estimate of expected credit losses uses a broader range of reasonable and supportable information. This change will result in earlier recognition of credit losses. ASU 2016-13 is effective for annual reporting periods, and interim periods within those years, beginning after December 15, 2019. We are currently evaluating the impact of this standard on our consolidated financial statements, including accounting policies, processes, and systems.

In October 2016, the FASB issued ASU 2016-16, *Income Taxes: Intra-Entity Transfers of Assets Other Than Inventory (Topic 740)* (ASU 2016-16), which removes the prohibition in ASC 740 against the immediate recognition of the current and deferred income tax effects of intra-entity transfers of assets other than inventory. Under ASU 2016-16, the selling entity is required to recognize a current tax expense or benefit upon transfer of the asset. Similarly, the purchasing entity is required to recognize a deferred tax asset or deferred tax liability, as well as the related deferred tax benefit or expense, upon receipt of the asset. The resulting deferred tax asset or deferred tax liability is measured by computing the difference between the tax basis of the asset in the buyer's jurisdiction and its financial reporting carrying value in the consolidated financial statements and multiplying such difference by the enacted tax rate in the buyer's jurisdiction. ASU 2016-16 is effective for fiscal years beginning after December 15, 2017 with early adoption permitted. We adopted this standard effective January 1, 2018 using the modified retrospective transition method, recognizing a $0.8 million one-time decrease to accumulated deficit.

In March 2017, the FASB issued ASU 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost* (ASU 2017-07), which provides additional guidance on the presentation of net benefit costs in the income statement. ASU 2017-07 requires an employer to disaggregate the service cost component from the other components of net benefit cost and to disclose other components outside of a subtotal of income from operations. It also allows only the service cost component of net benefit costs to be eligible for capitalization. ASU 2017-07 is effective for fiscal years beginning after December 15, 2017 with early adoption permitted.

We adopted this standard on January 1, 2018 retrospectively for the presentation of the service cost component of net periodic pension cost in the statement of operations, and prospectively for the capitalization of the service cost component of net periodic pension cost. For applying the retrospective presentation requirements, we elected to utilize amounts previously disclosed in our defined benefit pension plan footnote for the prior comparative periods as the estimation basis for applying the retrospective presentation. This resulted in a reclassification of an immaterial amount of net periodic pension benefit costs from operating income to other income (expense) in all periods presented on the Consolidated Statements of Operations.

In August 2017, the FASB issued ASU 2017-12, *Targeted Improvements to Accounting for Hedging Activities*, which amends and simplifies existing guidance in order to allow companies to more accurately present the economic effects of risk management activities in the financial statements. This update expands and refines hedge accounting for both nonfinancial and financial risk components and aligns the recognition and presentation of the effects of the hedging instrument and the hedged item in the financial statements. Additionally, the amendments in ASU 2017-12 provide new guidance about income statement classification and eliminates the requirement to separately measure and report hedge ineffectiveness. ASU 2017-12 is effective for fiscal years beginning after December 15, 2018, with early adoption permitted. We adopted this standard on April 1, 2018 and it did not materially impact our consolidated results of operations, financial position, cash flows, or related financial statement disclosures. In October 2018 the FASB issued ASU 2018-16, *Inclusion of the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as a Benchmark Interest Rate for Hedge Accounting Purposes* and is effective for Itron for the first quarter of 2019. This update establishes OIS rates based on SOFR as an approved benchmark interest rate in addition to existing rates such as the LIBOR swap rate.

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In August 2018, the FASB issued ASU 2018-13, *Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement* (ASU 2018-13) which amends the disclosure requirements under ASC 820, *Fair Value Measurements*. ASU 2018-13 is effective for us beginning with our interim financial reports for the first quarter of 2020.

In August 2018, the FASB issued ASU 2018-14, *Disclosure Framework—Changes to the Disclosure Requirements for Defined Benefit Plans* (ASU 2018-14) which amends the disclosure requirements under ASC 715-20, *Compensation—Retirement Benefits—Defined Benefit Plans*. ASU 2018-14 is effective for our financial reporting in 2020. We are currently evaluating the impact this standard will have on our financial statement disclosures for our defined benefit plan.

Note 2: Earnings Per Share

The following table sets forth the computation of basic and diluted earnings (loss) per share (EPS):

	Year Ended December 31,		
	2018	2017	2016
	(in thousands, except per share data)		
Net income (loss) available to common shareholders	$ (99,250)	$ 57,298	$ 31,770
Weighted average common shares outstanding - Basic	39,244	38,655	38,207
Dilutive effect of stock-based awards	—	732	436
Weighted average common shares outstanding - Diluted	39,244	39,387	38,643
Earnings (loss) per common share - Basic	$ (2.53)	$ 1.48	$ 0.83
Earnings (loss) per common share - Diluted	$ (2.53)	$ 1.45	$ 0.82

Stock-based Awards
For stock-based awards, the dilutive effect is calculated using the treasury stock method. Under this method, the dilutive effect is computed as if the awards were exercised at the beginning of the period (or at time of issuance, if later) and assumes the related proceeds were used to repurchase our common stock at the average market price during the period. Related proceeds include the amount the employee must pay upon exercise and future compensation cost associated with the stock award. Approximately
1.1 million, 0.2 million, and 0.7 million shares related to stock-based awards were excluded from the calculation of diluted EPS for the years ended December 31, 2018, 2017, and 2016, respectively, because they were anti-dilutive. These stock-based awards could be dilutive in future periods.

Note 3: Certain Balance Sheet Components

Accounts receivable, net	December 31, 2018	December 31, 2017
	(in thousands)	
Trade receivables (net of allowance of $6,331 and $3,957)	$416,503	$ 369,047
Unbilled receivables	20,658	28,982
Total accounts receivable, net	$437,161	$ 398,029

Allowance for doubtful account activity	**Year Ended December 31,**		
	2018	**2017**	**2016**
	(in thousands)		
Beginning balance	$3,957	$3,320	$5,949
Provision for doubtful accounts, net	3,874	1,656	60
Accounts written-off	(1,281)	(1,351)	(2,422)
Effects of change in exchange rates	(219)	332	(267)
Ending balance	$6,331	$3,957	$3,320

Inventories	December 31, 2018	December 31, 2017
	(in thousands)	
Materials	$133,398	$ 126,656
Work in process	9,744	9,863
Finished goods	77,532	57,316
Total inventories	$220,674	$ 193,835

Property, plant, and equipment, net	December 31, 2018	December 31, 2017
	(in thousands)	
Machinery and equipment	$315,974	$ 310,753
Computers and software	104,290	104,384
Buildings, furniture, and improvements	146,071	135,566
Land	14,980	18,433
Construction in progress, including purchased equipment	49,682	39,946
Total cost	630,997	609,082
Accumulated depreciation	(404,446)	(408,314)
Property, plant, and equipment, net	$226,551	$ 200,768

Depreciation expense	Year Ended December 31, 2018	2017	2016
	(in thousands)		
Depreciation expense	$50,784	$42,430	$43,206

Note 4: Intangible Assets and Liabilities

The gross carrying amount and accumulated amortization (accretion) of our intangible assets and liabilities, other than goodwill, are as follows:

	December 31, 2018			December 31, 2017		
	Gross Assets	Accumulated (Amortization) Accretion	Net	Gross Assets	Accumulated (Amortization) Accretion	Net
	(in thousands)					
Intangible Assets						
Core-developed technology	$507,100	$ (429,955)	$77,145	$429,548	$ (399,969)	$29,579
Customer contracts and relationships	379,614	(212,538)	167,076	258,586	(197,582)	61,004
Trademarks and trade names	78,746	(69,879)	8,867	70,056	(66,004)	4,052
Other	12,600	(11,205)	1,395	11,661	(11,068)	593
Total intangible assets subject to amortization	978,060	(723,577)	254,483	769,851	(674,623)	95,228
In-process research and development	3,100		3,100	—		—
Total intangible assets	$981,160	$ (723,577)	$257,583	$769,851	$ (674,623)	$95,228

Intangible Liabilities						
Customer contracts and relationships	$(23,900)	$ 5,217	$(18,683)	$—	$ —	$—

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A summary of the intangible assets and liabilities account activity is as follows:

	Year Ended December 31,	
	2018	2017
	(in thousands)	
Beginning balance, intangible assets, gross	$ 769,851	$ 669,896
Intangible assets acquired	242,039	36,500
Effect of change in exchange rates	(30,730)	63,455
Ending balance, intangible assets, gross	$ 981,160	$ 769,851
Beginning balance, intangible liabilities, gross	$ —	$ —
Intangible liabilities acquired	(23,900)	—
Effect of change in exchange rates	—	—
Ending balance, intangible liabilities, gross	$ (23,900)	$ —

On January 5, 2018, we completed our acquisition of SSNI by purchasing 100% of the voting stock. Intangible assets acquired in 2018 are primarily based on the purchase price allocation relating to this acquisition. Acquired intangible assets include in-process research and development IPR&D, which is not amortized until such time as the associated development projects are completed. Of these projects, $11.3 million were completed during the twelve months ended December 31, 2018 and are included in core-developed technology. The remaining IPR&D is expected to be completed in the next year. Acquired intangible liabilities reflect the present value of the projected cash outflows for an existing contract where remaining costs are expected to exceed projected revenues. Refer to "Note 17: Business Combinations" for additional information regarding this acquisition.

A summary of intangible asset amortization expense is as follows:

	Year Ended December 31,		
	2018	2017	2016
	(in thousands)		
Amortization expense	$71,713	$20,785	$25,112

We recognized net amortization of intangible assets for the year ended December 31, 2018, 2017 and 2016, respectively within operating expenses in the Consolidated Statements of Operations. These expenses relate to intangible assets and liabilities acquired as part of a business combination.

Estimated future annual amortization (accretion) is as follows:

Year Ending December 31,	**Amortization**	**Accretion**	**Estimated Annual Amortization, net**
	(in thousands)		
2019	$72,512	$(8,233)	$ 64,279
2020	52,591	(8,028)	44,563
2021	37,124	(1,963)	35,161
2022	26,950	(459)	26,491
2023	19,363	—	19,363
Beyond 2023	45,943	—	45,943
Total intangible assets subject to amortization	$254,483	$(18,683)	$ 235,800

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Note 5: Goodwill

The following table reflects changes in the carrying amount of goodwill for the years ended December 31, 2018 and 2017:

	(in thousands)
Goodwill balance at January 1, 2017	$452,494
Goodwill acquired	59,675
Effect of change in exchange rates	43,593
Goodwill balance at December 31, 2017	555,762
Goodwill acquired	575,750
Effect of change in exchange rates	(14,979)
Goodwill balance at December 31, 2018	$1,116,533

The accumulated goodwill impairment losses at December 31, 2018 and 2017 were $676.5 million. The goodwill impairment losses were originally recognized in 2011.

Effective October 1, 2018, we reorganized our operating segmentation from Electricity, Gas, Water, and Networks to Device Solutions, Networked Solutions, and Outcomes. A fair value calculation was performed to allocate goodwill from the previous reporting units to the new reporting units, using a relative fair value method. This reorganization was effective at the same date as our regular annual goodwill impairment test date, performed as of October 1. We performed quantitative assessments under both our previous reporting units and our new reporting units. As a result of these assessments, there was no impairment of the carrying value of goodwill.

The following table reflects the changes in goodwill by segment from October 1, 2018, the date of the reorganization of our operating segments:

	Device Solutions	Networked Solutions	Outcomes	Total Company
	(in thousands)			
Goodwill balance at October 1, 2018	$55,770	$922,889	$143,236	$1,121,895
Measurement period adjustments to goodwill acquired	—	4,097	863	4,960
Effect of change in exchange rates	(511)	(8,491)	(1,320)	(10,322)
Goodwill balance at December 31, 2018	$55,259	$918,495	$142,779	$1,116,533

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Note 6: Debt

The components of our borrowings are as follows:

	December 31, 2018	December 31, 2017
	(in thousands)	
Credit facilities		
USD denominated term loan	$637,813	$ 194,063
Multicurrency revolving line of credit	—	125,414
Senior notes	400,000	300,000
Total debt	1,037,813	619,477
Less: current portion of debt	28,438	19,688
Less: unamortized prepaid debt fees - term loan	4,859	629
Less: unamortized prepaid debt fees - senior notes	16,331	5,588
Long-term debt	$988,185	$ 593,572

Credit Facility

On January 5, 2018, we entered into a credit agreement providing for committed credit facilities in the amount of $1.2 billion U.S. dollars (the 2018 credit facility) which amended and restated in its entirety our credit agreement dated June 23, 2015 and replaced committed facilities in the amount of $725 million. The 2018 credit facility consists of a $650 million U.S. dollar term loan (the term loan) and a multicurrency revolving line of credit (the revolver) with a principal amount of up to $500 million. The revolver also contains a $300 million standby letter of credit sub-facility and a $50 million swingline sub-facility. Both the term loan and the revolver mature on January 5, 2023 and can be repaid without penalty. Amounts repaid on the term loan may not be reborrowed and amounts borrowed under the revolver may be repaid and reborrowed until the revolver's maturity, at which time all outstanding loans together with all accrued and unpaid interest must be repaid. Amounts not borrowed under the revolver are subject to a commitment fee, which is paid in arrears on the last day of each fiscal quarter, ranging from 0.18% to 0.35% per annum depending on our total leverage ratio as of the most recently ended fiscal quarter.

The 2018 credit facility permits us and certain of our foreign subsidiaries to borrow in U.S. dollars, euros, British pounds, or, with lender approval, other currencies readily convertible into U.S. dollars. All obligations under the 2018 credit facility are guaranteed by Itron, Inc. and material U.S. domestic subsidiaries and are secured by a pledge of substantially all of the assets of Itron, Inc. and material U.S. domestic subsidiaries, including a pledge of their related assets. This includes a pledge of 100% of the capital stock of material U.S. domestic subsidiaries and up to 66% of the voting stock (100% of the non-voting stock) of first-tier foreign subsidiaries. In addition, the obligations of any foreign subsidiary who is a foreign borrower, as defined by the 2018 credit facility, are guaranteed by the foreign subsidiary and by its direct and indirect foreign parents. The 2018 credit facility includes debt covenants, which contain certain financial thresholds and place certain restrictions on the incurrence of debt, investments, and the issuance of dividends. We were in compliance with the debt covenants under the 2018 credit facility at December 31, 2018.

Under the 2018 credit facility, we elect applicable market interest rates for both the term loan and any outstanding revolving loans. We also pay an applicable margin, which is based on our total leverage ratio as defined in the credit agreement. The applicable rates per annum may be based on either: (1) the LIBOR rate or EURIBOR rate (subject to a floor of 0%), plus an applicable margin, or (2) the Alternate Base Rate, plus an applicable margin. The Alternate Base Rate election is equal to the greatest of three rates: (i) the prime rate, (ii) the Federal Reserve effective rate plus 0.50%, or (iii) one month LIBOR plus 1%. At December 31, 2018, the interest rates for both the term loan and the revolver was 4.28%, which includes the LIBOR rate plus a margin of 1.75%.

Total credit facility repayments were as follows:

	Year Ended December 31,		
	2018	2017	2016
	(in thousands)		
Term loan	$12,187	$14,063	$11,250
Multicurrency revolving line of credit	351,172	15,000	67,869
Total credit facility repayments	$363,359	$29,063	$79,119

At December 31, 2018, no amount was outstanding under the 2018 credit facility revolver, and $41.0 million was utilized by outstanding standby letters of credit, resulting in $459.0 million available for additional borrowings or standby letters of credit. At December 31, 2018, $259.0 million was available for additional standby letters of credit under the letter of credit sub-facility and no amounts were outstanding under the swingline sub-facility.

Senior Notes
On December 22, 2017 and January 19, 2018, we issued $300 million and $100 million, respectively, of aggregate principal amount of 5.00% senior notes maturing January 15, 2026 (Notes). The proceeds were used to refinance existing indebtedness related to the acquisition of SSNI, pay related fees and expenses, and for general corporate purposes. Interest on the Notes is payable semi-annually in arrears on January 15 and July 15, commencing on July 15, 2018. The Notes are fully and unconditionally guaranteed, jointly and severally, on a senior unsecured basis by each of our subsidiaries that guarantee the senior credit facilities.

Prior to maturity we may redeem some or all of the Notes, together with accrued and unpaid interest, if any, plus a "make-whole" premium. On or after January 15, 2021, we may redeem some or all of the Notes at any time at declining redemption prices equal to 102.50% beginning on January 15, 2021, 101.25% beginning on January 15, 2022 and 100.00% beginning on January 15, 2023 and thereafter to the applicable redemption date. In addition, before January 15, 2021, and subject to certain conditions, we may redeem up to 35% of the aggregate principal amount of Notes with the net proceeds of certain equity offerings at 105.00% thereof to the date of redemption; provided that (i) at least 65% of the aggregate principal amount of Notes remains outstanding after such redemption and (ii) the redemption occurs within 60 days of the closing of any such equity offering.

Debt Maturities
The amount of required minimum principal payments on our long-term debt in aggregate over the next five years, are as follows:

Year Ending December 31,	**Minimum Payments (in thousands)**
2019	$ 28,438
2020	44,688
2021	60,937
2022	65,000
2023	438,750
Total minimum payments on debt	$ 637,813

Note 7: Derivative Financial Instruments

As part of our risk management strategy, we use derivative instruments to hedge certain foreign currency and interest rate exposures. Refer to "Note 1: Summary of Significant Accounting Policies", "Note 14: Shareholders' Equity", and "Note 15: Fair Values of Financial Instruments" for additional disclosures on our derivative instruments.

The fair values of our derivative instruments are determined using the income approach and significant other observable inputs (also known as "Level 2"). We have used observable market inputs based on the type of derivative and the nature of the underlying instrument. The key inputs include interest rate yield curves (swap rates and futures) and foreign exchange spot and forward rates, all of which are available in an active market. We have utilized the mid-market pricing convention for these inputs. We include, as a discount to the derivative asset, the effect of our counterparty credit risk based on current published credit default swap rates when the net fair value of our derivative instruments is in a net asset position. We consider our own nonperformance risk when the net fair value of our derivative instruments is in a net liability position by discounting our derivative liabilities to reflect the potential credit risk to our counterparty through applying a current market indicative credit spread to all cash flows.

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The fair values of our derivative instruments are as follows:

	Balance Sheet Location	Fair Value December 31, 2018	Fair Value December 31, 2017
Derivatives Asset		**(in thousands)**	
Derivatives designated as hedging instruments under Subtopic ASC 815-20			
Interest rate swap contracts	Other current assets	$1,866	$ 658
Interest rate cap contracts	Other current assets	535	17
Cross currency swap contract	Other current assets	1,631	—
Interest rate swap contracts	Other long-term assets	746	1,712
Interest rate cap contracts	Other long-term assets	251	179
Cross currency swap contract	Other long-term assets	1,339	—
Derivatives not designated as hedging instruments under Subtopic ASC 815-20			
Foreign exchange forward contracts	Other current assets	157	41
Interest rate cap contracts	Other current assets	—	25
Interest rate cap contracts	Other long-term assets	—	268
Total asset derivatives		$6,525	$ 2,900
Derivatives Liabilities			
Derivatives not designated as hedging instruments under Subtopic ASC 815-20			
Foreign exchange forward contracts	Other current liabilities	$337	$ 289

The change in AOCI, net of tax, for our derivative and nonderivative instruments designated as hedging instruments, net of tax, were as follows:

	2018	2017	2016
	(in thousands)		
Net unrealized loss on hedging instruments at January 1,	$(13,414)	$(14,337)	$(14,062)
Unrealized gain (loss) on derivative instruments	2,586	360	(1,087)
Realized (gains) losses reclassified into net income (loss)	(2,351)	563	812
Net unrealized loss on hedging instruments at December 31,	$(13,179)	$(13,414)	$(14,337)

Reclassification of amounts related to hedging instruments are included in interest expense in the Consolidated Statements of Operations. Included in the net unrealized gain (loss) on hedging instruments at December 31, 2018 and 2017 is a loss of $14.4 million, net of tax, related to our nonderivative net investment hedge, which terminated in 2011. This loss on our net investment hedge will remain in AOCI until such time as earnings are impacted by a sale or liquidation of the associated foreign operation.

A summary of the potential effect of netting arrangements on our financial position related to the offsetting of our recognized derivative assets and liabilities under master netting arrangements or similar agreements is as follows:

Offsetting of Derivative Assets

		Gross Amounts Not Offset in the Consolidated Balance Sheets		
	Gross Amounts of Recognized Assets Presented in the Consolidated Balance Sheets	Derivative Financial Instruments	Cash Collateral Received	Net Amount
	(in thousands)			
December 31, 2018	$6,525	$ (103)	$ —	$ 6,422
December 31, 2017	$2,900	$ (90)	$ —	$ 2,810

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Offsetting of Derivative Liabilities

	Gross Amounts of Recognized Liabilities Presented in the Consolidated Balance Sheets	Gross Amounts Not Offset in the Consolidated Balance Sheets: Derivative Financial Instruments	Gross Amounts Not Offset in the Consolidated Balance Sheets: Cash Collateral Pledged	Net Amount
	(in thousands)			
December 31, 2018	$337	$ (103)	$ —	$ 234
December 31, 2017	$289	$ (90)	$ —	$ 199

Our derivative assets and liabilities subject to netting arrangements consist of foreign exchange forward and interest rate contracts with five counterparties at December 31, 2018 and three counterparties at December 31, 2017. No derivative asset or liability balance with any of our counterparties was individually significant at December 31, 2018 or 2017. Our derivative contracts with each of these counterparties exist under agreements that provide for the net settlement of all contracts through a single payment in a single currency in the event of default. We have no pledges of cash collateral against our obligations and we have not received pledges of cash collateral from our counterparties under the associated derivative contracts.

Cash Flow Hedges

As a result of our floating rate debt, we are exposed to variability in our cash flows from changes in the applicable interest rate index. We enter into interest rate caps and swaps to reduce the variability of cash flows from increases in the LIBOR based borrowing rates on our floating rate credit facility. These instruments do not protect us from changes to the applicable margin under our credit facility. At December 31, 2018, our LIBOR-based debt balance was $637.8 million.

In October 2015, we entered into an interest rate swap, which is effective from August 31, 2016 to June 23, 2020, and converts $214 million of our LIBOR based debt from a floating LIBOR interest rate to a fixed interest rate of 1.42% (excluding the applicable margin on the debt). The notional balance will amortize to maturity at the same rate as required minimum payments on our term loan. Changes in the fair value of the interest rate swap are recognized as a component of other comprehensive income (OCI) and are recognized in earnings when the hedged item affects earnings. The amounts paid or received on the hedge are recognized as an adjustment to interest expense along with the earnings effect of the hedged item. The amount of net gains (loss) expected to be reclassified into earnings in the next 12 months is $1.9 million.

In November 2015, we entered into three interest rate cap contracts with a total notional amount of $100 million at a cost of $1.7 million. The interest rate cap contracts expire on June 23, 2020 and were entered into in order to limit our interest rate exposure on $100 million of our variable LIBOR based debt up to 2.00%. In the event LIBOR is higher than 2.00%, we will pay interest at the capped rate of 2.00% with respect to the $100 million notional amount of such agreements. The interest rate cap contracts do not include the effect of the applicable margin. As of December 31, 2016, due to the accelerated revolver payments from surplus cash, we elected to de-designate two of the interest rate cap contracts as cash flow hedges and discontinued the use of cash flow hedge accounting. The amounts recognized in AOCI from de-designated interest rate cap contracts were maintained in AOCI as the forecasted transactions were still probable to occur, and subsequent changes in fair value were recognized within interest expense. In April 2018, due to increases in our total LIBOR-based debt, we elected to re-designate the two interest rate cap contracts as cash flow hedges. Future changes in the fair value of these instruments will be recognized as a component of OCI, and these changes together with amounts previously maintained in AOCI will be recognized in earnings when the hedged item affects earnings. The amounts paid or received on the hedge are recognized as an adjustment to interest expense along with the earnings effect of the hedged item. The amount of net losses expected to be reclassified into earnings for all interest rate cap contracts in the next 12 months is $0.2 million.

In April 2018, we entered into a cross-currency swap which converts $56.0 million of floating LIBOR-based U.S. Dollar denominated debt into 1.38% fixed rate euro denominated debt. This cross-currency swap matures on April 30, 2021 and mitigates the risk associated with fluctuations in currency rates impacting cash flows related to U.S. Dollar denominated debt in a euro functional currency entity. Changes in the fair value of the cross-currency swap are recognized as a component of OCI and will be recognized in earnings when the hedged item affects earnings. The amounts paid or received on the hedge are recognized as an adjustment to interest expense along with the earnings effect of the hedged item. The amount of net gains expected to be reclassified into earnings in the next 12 months is $1.6 million.

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The before-tax effects of our accounting for derivative instruments designated as hedges on the Consolidated Balance Sheets and the Consolidated Statements of Operations were as follows:

Derivatives in Subtopic ASC 815-20 Cash Flow Hedging Relationships	**Amount of Gain (Loss) Recognized in OCI on Derivative**			**Gain (Loss) Reclassified from AOCI into Income**			
				Location	**Amount**		
	2018	**2017**	**2016**		**2018**	**2017**	**2016**
	(in thousands)				**(in thousands)**		
Interest rate swap contracts	$1,306	$768	$(1,163)	Interest expense	$1,065	$(706)	$(1,296)
Interest rate cap contracts	18	(183)	(605)	Interest expense	(439)	(210)	(27)
Cross currency swap contract	1,584	—	—	Interest expense	949	—	—
Cross currency swap contract	—	—	—	Other income (expense), net	932	—	—

Derivatives Not Designated as Hedging Relationships
We are also exposed to foreign exchange risk when we enter into non-functional currency transactions, both intercompany and third-party. At each period-end, non-functional currency monetary assets and liabilities are revalued with the change recognized to other income and expense. We enter into monthly foreign exchange forward contracts, which are not designated for hedge accounting, with the intent to reduce earnings volatility associated with currency exposures. As of December 31, 2018, a total of 57 contracts were offsetting our exposures from the Euro, Pound Sterling, New Zealand dollar, Swedish Krona, Hungarian Forint and various other currencies, with notional amounts ranging from $107,000 to $47.5 million.

The effect of our derivative instruments not designated as hedges on the Consolidated Statements of Operations was as follows:

Derivatives Not Designated as Hedging Instrument under Subtopic ASC 815-20	**Location**	**Gain (Loss) Recognized in Income on Derivative**		
		2018	**2017**	**2016**
		(in thousands)		
Foreign exchange forward contracts	Other income (expense), net	$3,448	$(6,281)	$537
Interest rate cap contracts	Interest expense	377	(274)	129

We will continue to monitor and assess our interest rate and foreign exchange risk and may institute additional derivative instruments to manage such risk in the future.

Note 8: Defined Benefit Pension Plans

We sponsor both funded and unfunded defined benefit pension plans offering death and disability, retirement, and special termination benefits for certain of our international employees, primarily in Germany, France, Italy, Indonesia, Brazil, and Spain. The defined benefit obligation is calculated annually by using the projected unit credit method. The measurement date for the pension plans was December 31, 2018.

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The following tables set forth the components of the changes in benefit obligations and fair value of plan assets:

	Year Ended December 31,	
	2018	2017
	(in thousands)	
Change in benefit obligation:		
Benefit obligation at January 1,	$ 110,820	$ 97,261
Service cost	4,034	3,968
Interest cost	2,324	2,264
Actuarial (gain) loss	(2,497)	(2,351)
Benefits paid	(3,018)	(3,136)
Foreign currency exchange rate changes	(5,110)	13,014
Curtailment	(694)	(858)
Settlement	(413)	(175)
Other	124	833
Benefit obligation at December 31,	$ 105,570	$ 110,820
Change in plan assets:		
Fair value of plan assets at January 1,	$ 12,834	$ 10,215
Actual return on plan assets	(54)	786
Company contributions	465	399
Benefits paid	(392)	(383)
Foreign currency exchange rate changes	(963)	984
Other	—	833
Fair value of plan assets at December 31,	11,890	12,834
Net pension benefit obligation at fair value	$ 93,680	$ 97,986

Amounts recognized on the Consolidated Balance Sheets consist of:

	At December 31,	
	2018	2017
	(in thousands)	
Assets		
Plan assets in other long-term assets	$ 572	$ 991
Liabilities		
Current portion of pension benefit obligation in wages and benefits payable	2,730	3,260
Long-term portion of pension benefit obligation	91,522	95,717
Pension benefit obligation, net	$ 93,680	$ 97,986

Amounts recognized in OCI (pre-tax) are as follows:

	Year Ended December 31,		
	2018	2017	2016
	(in thousands)		
Net actuarial (gain) loss	$ (3,191)	$ (3,209)	$ 6,316

Settlement (gain) loss	(1)	2	(1,343)
Curtailment (gain) loss	(1)	586	—
Plan asset (gain) loss	724	(192)	(64)
Amortization of net actuarial loss	(1,533)	(2,308)	(1,351)
Amortization of prior service cost	(61)	(62)	(58)
Other	124	—	4
Other comprehensive (income) loss	$(3,939)	$(5,183)	$3,504

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If actuarial gains and losses exceed ten percent of the greater of plan assets or plan liabilities, we amortize them over the employees' average future service period. The estimated net actuarial loss and prior service cost that will be amortized from AOCI into net periodic benefit cost during 2019 is $1.4 million.

Net periodic pension benefit costs for our plans include the following components:

	Year Ended December 31,		
	2018	2017	2016
	(in thousands)		
Service cost	$4,034	$3,968	$3,472
Interest cost	2,324	2,264	2,573
Expected return on plan assets	(670)	(594)	(540)
Amortization of prior service costs	61	62	58
Amortization of actuarial net loss	1,533	2,308	1,351
Settlement	1	(2)	1,343
Curtailment	1	(586)	—
Other	—	—	(3)
Net periodic benefit cost	$7,284	$7,420	$8,254

The significant actuarial weighted average assumptions used in determining the benefit obligations and net periodic benefit cost for our benefit plans are as follows:

	At and For The Year Ended December 31,		
	2018	2017	2016
Actuarial assumptions used to determine benefit obligations at end of period:			
Discount rate	2.24%	2.21%	2.18%
Expected annual rate of compensation increase	3.60%	3.64%	3.65%
Actuarial assumptions used to determine net periodic benefit cost for the period:			
Discount rate	2.21%	2.18%	2.59%
Expected rate of return on plan assets	5.58%	5.58%	5.29%
Expected annual rate of compensation increase	3.64%	3.65%	3.60%

We determine a discount rate for our plans based on the estimated duration of each plan's liabilities. For our euro denominated defined benefit pension plans, which represent 94% of our benefit obligation, we use two discount rates with consideration of the duration of the plans, using a hypothetical yield curve developed from euro-denominated AA-rated corporate bond issues. These bond issues are partially weighted for market value, with minimum amounts outstanding of €500 million for bonds with less than 10 years to maturity and €50 million for bonds with 10 or more years to maturity, and excluding the highest and lowest yielding 10% of bonds within each maturity group. The discount rates used, depending on the duration of the plans, were 1.00% and 1.75%.

Our expected rate of return on plan assets is derived from a study of actual historic returns achieved and anticipated future long-term performance of plan assets, specific to plan investment asset category. While the study primarily gives consideration to recent insurers' performance and historical returns, the assumption represents a long-term prospective return.

The total accumulated benefit obligation for our defined benefit pension plans was $97.3 million and $101.4 million at

December 31, 2018 and 2017, respectively.

The total obligations and fair value of plan assets for plans with projected benefit obligations and accumulated benefit obligations exceeding the fair value of plan assets are as follows:

	At December 31,	
	2018	**2017**
	(in thousands)	
Projected benefit obligation	$103,059	$106,486
Accumulated benefit obligation	94,831	97,546
Fair value of plan assets	8,807	7,509

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Our asset investment strategy focuses on maintaining a portfolio using primarily insurance funds, which are accounted for as investments and measured at fair value, in order to achieve our long-term investment objectives on a risk adjusted basis. Our general funding policy for these qualified pension plans is to contribute amounts sufficient to satisfy regulatory funding standards of the respective countries for each plan.

The fair values of our plan investments by asset category are as follows:

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Unobservable Inputs (Level 3)
	(in thousands)		
	December 31, 2018		
Cash	$787	$ 787	$ —
Insurance funds	8,020	—	8,020
Other securities	3,083	—	3,083
Total fair value of plan assets	$11,890	$ 787	$ 11,103
	December 31, 2017		
Cash	$789	$ 789	$ —
Insurance funds	8,384	—	8,384
Other securities	3,661	—	3,661
Total fair value of plan assets	$12,834	$ 789	$ 12,045

The following tables present a reconciliation of Level 3 assets held during the years ended December 31, 2018 and 2017.

	Balance at January 1, 2018	Net Realized and Unrealized Gains	Net Purchases, Issuances, Settlements, and Other	Net Transfers Into Level 3	Effect of Foreign Currency	Balance at December 31, 2018
	(in thousands)					
Insurance funds	$8,384	$ (158)	$ 141	$ —	$ (347)	$ 8,020
Other securities	3,661	123	(141)	—	(560)	3,083
Total	$12,045	$ (35)	$ —	$ —	$ (907)	$ 11,103

	Balance at January 1, 2017	Net Realized and Unrealized Gains	Net Purchases, Issuances, Settlements, and Other	Net Transfers Into Level 3	Effect of Foreign Currency	Balance at December 31, 2017
	(in thousands)					
Insurance funds	$7,011	$ 257	$ 102	$ —	$ 1,014	$ 8,384
Other securities	2,421	523	(93)	833	(23)	3,661
Total	$9,432	$ 780	$ 9	$ 833	$ 991	$ 12,045

As the plan assets and contributions are not significant to our total company assets, no further disclosures are considered material.

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Annual benefit payments for the next 10 years, including amounts to be paid from our assets for unfunded plans and reflecting expected future service, as appropriate, are expected to be paid as follows:

Year Ending December 31,	Estimated Annual Benefit Payments (in thousands)
2019	$ 3,522
2020	3,412
2021	3,574
2022	4,051
2023	4,439
2024-2028	27,604

Note 9: Stock-Based Compensation

We maintain the Second Amended and Restated 2010 Stock Incentive Plan (Stock Incentive Plan), which allows us to grant stock-based compensation awards, including stock options, restricted stock units, phantom stock, and unrestricted stock units. Under the Stock Incentive Plan, we have 12,623,538 shares of common stock reserved and authorized for issuance subject to stock splits, dividends, and other similar events. At December 31, 2018, 6,473,623 shares were available for grant under the Stock Incentive Plan. We issue new shares of common stock upon the exercise of stock options or when vesting conditions on restricted stock units are fully satisfied. These shares are subject to a fungible share provision such that the authorized share reserve is reduced by (i) one share for every one share subject to a stock option or share appreciation right granted under the Plan and (ii) 1.7 shares for every one share of common stock that was subject to an award other than an option or share appreciation right.

As part of the acquisition of SSNI, we reserved and authorized 2,322,371 shares, collectively, of Itron common stock to be issued under the Stock Incentive Plan for certain SSNI common stock awards that were converted to Itron common stock awards on January 5, 2018 (Acquisition Date) pursuant to the Agreement and Plan of Merger or were available for issuance pursuant to future awards under the Silver Spring Networks, Inc. 2012 Equity Incentive Plan (SSNI Plan). New stock-based compensation awards originally from the SSNI Plan may only be made to individuals who were not employees of Itron as of the Acquisition Date. Notwithstanding the foregoing, there is no fungible share provision for shares originally from the SSNI Plan.

We also periodically award phantom stock units, which are settled in cash upon vesting and accounted for as liability-based awards with no impact to the shares available for grant.

In addition, we maintain the ESPP, for which 291,934 shares of common stock were available for future issuance at December 31, 2018.

Unrestricted stock and ESPP activity for the years ended December 31, 2018, 2017, and 2016 was not significant.

Stock-Based Compensation Expense

Total stock-based compensation expense and the related tax benefit were as follows:

	2018	2017	2016
	(in thousands)		
Stock options	$3,675	$2,695	$2,357
Restricted stock units	26,859	17,738	14,723
Unrestricted stock awards	729	974	955

Phantom stock units	2,165	1,747	1,077
Total stock-based compensation	$33,428	$23,154	$19,112
Related tax benefit	$6,019	$5,034	$4,927

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Stock Options

A summary of our stock option activity is as follows:

	Shares	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value	Weighted Average Grant Date Fair Value
	(in thousands)		(years)	(in thousands)	
Outstanding, January 1, 2016	1,180	$ 48.31	5.7	$ 405	
Granted	191	40.40			$ 13.27
Exercised	(58)	37.00		742	
Forfeited	(36)	35.29			
Expired	(318)	55.13			
Outstanding, December 31, 2016	959	$ 45.64	6.6	$ 19,125	
Granted	135	$ 65.94			$ 21.99
Exercised	(41)	39.92		$ 1,071	
Forfeited	(35)	47.38			
Expired	(62)	70.12			
Outstanding, December 31, 2017	956	$ 47.10	6.3	$ 21,965	
Converted upon acquisition	42	$ 51.86			$ 14.86
Granted	122	68.21			24.29
Exercised	(152)	38.99		$ 4,520	
Forfeited	(7)	60.03			
Expired	(66)	95.31			
Outstanding, December 31, 2018	895	$ 47.93	6.2	$ 4,806	
Exercisable, December 31, 2018	629	$ 42.30	5.3	$ 4,417	
Expected to vest, December 31, 2018	266	$ 61.23	8.4	$ 389	

At December 31, 2018, total unrecognized stock-based compensation expense related to unvested stock options was $2.6 million, which is expected to be recognized over a weighted average period of approximately 1.6 years.

The weighted-average assumptions used to estimate the fair value of stock options granted and the resulting weighted average fair value are as follows:

	Year Ended December 31,		
	2018	2017	2016
Expected volatility	30.5 %	32.5 %	33.5 %
Risk-free interest rate	2.8 %	2.0 %	1.3 %
Expected term (years)	6.1	5.5	5.5

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Restricted Stock Units

The following table summarizes restricted stock unit activity:

	Number of Restricted Stock Units (in thousands)	Weighted Average Grant Date Fair Value	Aggregate Intrinsic Value (in thousands)
Outstanding, January 1, 2016	756		
Granted	306	$ 41.58	
Released	(312)		$ 11,944
Forfeited	(49)		
Outstanding, December 31, 2016	701	$ 38.04	
Granted	273	$ 50.95	
Released	(372)		$ 14,219
Forfeited	(46)		
Outstanding, December 31, 2017	556	$ 47.68	
Converted upon acquisition	579	$ 69.40	
Granted	387	57.48	
Released	(593)	54.91	$ 32,567
Forfeited	(112)	67.88	
Outstanding, December 31, 2018	817	$ 59.70	
Vested but not released, December 31, 2018	124		$ 5,867
Expected to vest, December 31, 2018	643		$ 30,405

At December 31, 2018, total unrecognized compensation expense on restricted stock units was $38.5 million, which is expected to be recognized over a weighted average period of approximately 2.0 years.

The weighted-average assumptions used to estimate the fair value of performance-based restricted stock units granted and the resulting weighted average fair value are as follows:

	Year Ended December 31,		
	2018	2017	2016
Expected volatility	28.0 %	28.0 %	30.0 %
Risk-free interest rate	2.2 %	1.0 %	0.7 %
Expected term (years)	2.1	1.7	1.8
Weighted average grant date fair value	$78.56	$77.75	$44.92

Phantom Stock Units
The following table summarizes phantom stock unit activity:

	Number of Phantom Stock Units (in thousands)	Weighted Average Grant Date Fair Value
Outstanding, January 1, 2017	62	
Granted	32	$ 65.55
Released	(20)	
Forfeited	(11)	
Outstanding, December 31, 2017	63	
Expected to vest, December 31, 2017	63	
Outstanding, January 1, 2018	63	$ 62.53
Converted upon acquisition	21	69.40
Granted	41	66.67
Released	(35)	54.33
Forfeited	(7)	61.28
Outstanding, December 31, 2018	83	$ 61.80
Expected to vest, December 31, 2018	83	

At December 31, 2018, total unrecognized compensation expense on phantom stock units was $2.5 million, which is expected to be recognized over a weighted average period of approximately 1.9 years. As of December 31, 2018 and 2017, we have recognized a phantom stock liability of $1.5 million and $1.7 million, respectively, within wages and benefits payable in the Consolidated Balance Sheets.

Note 10: Defined Contribution, Bonus, and Profit Sharing Plans

Defined Contribution Plans
In the United States, United Kingdom, and certain other countries, we make contributions to defined contribution plans. For our U.S. employee savings plan, which represents a majority of our contribution expense, we provide a 75% match on the first 6% of the employee salary deferral, subject to statutory limitations. For our international defined contribution plans, we provide various levels of contributions, based on salary, subject to stipulated or statutory limitations. The expense for our defined contribution plans was as follows:

	Year Ended December 31,		
	2018	2017	2016
	(in thousands)		
Defined contribution plans expense	$11,593	$11,709	$7,941

Bonus and Profit Sharing Plans and Awards
We have employee bonus and profit sharing plans in which many of our employees participate, as well as an award program, which allows for recognition of individual employees' achievements. The bonus and profit sharing plans provide award amounts for the achievement of performance and financial targets. As the bonuses are being earned

during the year, we estimate a compensation accrual each quarter based on the progress towards achieving the goals, the estimated financial forecast for the year, and the probability of achieving results. Bonus and profit sharing plans and award expense was as follows:

	Year Ended December 31,		
	2018	**2017**	**2016**
	(in thousands)		
Bonus and profit sharing plans and award expense	$15,466	$40,005	$43,377

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Note 11: Income Taxes

On December 22, 2017, H.R.1, commonly referred to as the Tax Cuts and Jobs Act (Tax Act) was enacted into law in the United States. This new tax legislation represents one of the most significant overhauls to the U.S. federal tax code since 1986. The Tax Act lowered the U.S. corporate income tax rate from 35% to 21% effective January 1, 2018. The Tax Act also includes numerous provisions, including, but not limited to, (1) imposing a one-time transition tax on certain unrepatriated earnings of foreign subsidiaries that had not been previously taxed in the U.S.; (2) creating a new provision designed to tax global intangible low-tax income (GILTI); (3) generally eliminating U.S. federal taxes on dividends from foreign subsidiaries; (4) eliminating the corporate alternative minimum tax (AMT); (5) creating the base erosion anti-abuse tax (BEAT); (6) establishing the deduction for foreign derived intangible income (FDII); (7) repealing the domestic production activity deduction; and (8) establishing new limitations on deductible interest expense and certain executive compensation.

On December 22, 2017, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 118 (SAB 118) which provides guidance on accounting for the tax effects of the Tax Act. SAB 118 provides a measurement period that should not extend beyond one year from the Tax Act enactment date for companies to complete the accounting under ASC 740, *Income Taxes.* In accordance with SAB 118, a company must reflect the income tax effects of those aspects of the Tax Act for which the accounting under ASC 740 is complete. To the extent that a company's accounting for certain income tax effects of the Tax Act is incomplete but is able to determine a reasonable estimate, it must recognize a provisional estimate in the financial statements. Pursuant to SAB 118, we recognized provisional estimates for the impact of the Tax Act in 2017. This included a one-time tax charge of $30.4 million to remeasure our deferred tax assets as a result of these legislative changes. We have completed our accounting for the Tax Act, and we did not make any material adjustments to these provisional amounts for the year ended December 31, 2018.

The following table summarizes the provision (benefit) for U.S. federal, state, and foreign taxes on income from continuing operations:

	Year Ended December 31,		
	2018	**2017**	**2016**
	(in thousands)		
Current:			
Federal	$(7,695)	$7,679	$20,490
State and local	(362)	3,841	2,708
Foreign	14,618	12,139	12,586
Total current	6,561	23,659	35,784
Deferred:			
Federal	(17,463)	40,340	10,805
State and local	(4,492)	(1,144)	1,160
Foreign	(22,906)	3,480	(24,815)
Total deferred	(44,861)	42,676	(12,850)
Change in valuation allowance	25,730	7,991	26,640
Total provision (benefit) for income taxes	$(12,570)	$74,326	$49,574

The change in the valuation allowance does not include the impacts of currency translation adjustments, acquisitions, or significant intercompany transactions.

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Our tax provision (benefit) as a percentage of income before tax was 12%, 55%, and 59% for 2018, 2017, and 2016, respectively. Our actual tax rate differed from the 21% or 35% U.S. federal statutory tax rate due to various items. A reconciliation of income taxes at the U.S. federal statutory rate of 21% for 2018 and 35% for 2017 and 2016 to the consolidated actual tax rate is as follows:

	Year Ended December 31,		
	2018	**2017**	**2016**
	(in thousands)		
Income (loss) before income taxes			
Domestic	$(50,463)	$220,342	$196,750
Foreign	(58,688)	(85,767)	(112,123)
Total income before income taxes	$(109,151)	$134,575	$84,627
Expected federal income tax provision	$(22,922)	$47,101	$29,619
Change in valuation allowance	25,730	7,991	26,640
Stock-based compensation	(104)	(1,225)	2,762
Foreign earnings	(15,799)	(22,045)	(12,584)
Tax credits	(10,502)	(777)	(7,471)
Uncertain tax positions, including interest and penalties	7,727	(7,637)	3,817
Change in tax rates	335	41,125	67
State income tax provision (benefit), net of federal effect	(4,524)	4,986	2,806
U.S. tax provision on foreign earnings	25	33	997
Domestic production activities deduction	—	(2,534)	(2,424)
Local foreign taxes	2,540	2,324	2,914
Transaction costs	974	2,643	—
Other, net	3,950	2,341	2,431
Total provision (benefit) from income taxes	$(12,570)	$74,326	$49,574

Change in tax rates line above includes the deferred tax impact of material rate changes in 2017 to the U.S., France, and Luxembourg, among others.

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Deferred tax assets and liabilities consist of the following:

	At December 31,	
	2018	2017
	(in thousands)	
Deferred tax assets		
Loss carryforwards[1]	$370,120	$218,420
Tax credits[2]	94,359	58,616
Accrued expenses	43,213	23,752
Pension plan benefits expense	18,086	18,262
Warranty reserves	13,470	11,170
Depreciation and amortization	5,709	5,736
Equity compensation	5,390	5,352
Inventory valuation	1,415	2,554
Deferred revenue	9,062	2,431
Other deferred tax assets, net	11,319	16,606
Total deferred tax assets	572,143	362,899
Valuation allowance	(323,822)	(285,784)
Total deferred tax assets, net of valuation allowance	248,321	77,115
Deferred tax liabilities		
Depreciation and amortization	(178,358)	(23,135)
Tax effect of accumulated translation	—	(303)
Other deferred tax liabilities, net	(6,676)	(5,231)
Total deferred tax liabilities	(185,034)	(28,669)
Net deferred tax assets	$63,287	$48,446

(1) For tax return purposes at December 31, 2018, we had U.S. federal loss carryforwards of $350.7 million which begin to expire in the year 2019. At December 31, 2018, we have net operating loss carryforwards in Luxembourg of $936.7 million, the majority of which can be carried forward indefinitely, offset by a full valuation allowance. The remaining portion of the loss carryforwards are composed primarily of losses in various other state and foreign jurisdictions. The majority of these losses can be carried forward indefinitely. At December 31, 2018, there was a valuation allowance of $323.8 million primarily associated with foreign loss carryforwards and foreign tax credit carryforwards (discussed below).

(2) For tax return purposes at December 31, 2018, we had: (1) U.S. general business credits of $31.2 million, which begin to expire in 2022; (2) U.S. alternative minimum tax credits of $1.6 million that can be carried forward indefinitely; (3) U.S. foreign tax credits of $50.4 million, which begin to expire in 2024; and (4) state tax credits of $35.1 million, which begin to expire in 2019.

Changes in the valuation allowance for deferred tax assets are summarized as follows:

Description	Balance at Beginning of Period	Other Adjustments	Additions Charged to Costs and Expenses	Balance at End of Period, Noncurrent
	(in thousands)			
Year ended December 31, 2018:				
Deferred tax assets valuation allowance	$285,784	$ 12,308	$ 25,730	$ 323,822
Year ended December 31, 2017:				
Deferred tax assets valuation allowance	$249,560	$ 28,233	$ 7,991	$ 285,784
Year ended December 31, 2016:				

Deferred tax assets valuation allowance	$235,339	$ (12,419)	$ 26,640	$ 249,560

We recognize valuation allowances to reduce deferred tax assets to the extent we believe it is more likely than not that a portion of such assets will not be realized. In making such determinations, we consider all available favorable and unfavorable evidence, including scheduled reversals of deferred tax liabilities, projected future taxable income, tax planning strategies, and our ability to carry back losses to prior years. We are required to make assumptions and judgments about potential outcomes that lie outside management's control. Our most sensitive and critical factors are the projection, source, and character of future taxable income. Although realization is not assured, management believes it is more likely than not that deferred tax assets, net of valuation allowance, will be realized. The amount of deferred tax assets considered realizable, however, could be reduced in the near term

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if estimates of future taxable income during the carryforward periods are reduced or current tax planning strategies are not implemented.

We do not provide U.S. deferred taxes on temporary differences related to our foreign investments that are considered permanent in duration. These temporary differences include undistributed foreign earnings of $5.1 million and $5.2 million at December 31, 2018 and 2017, respectively. Foreign taxes have been provided on these undistributed foreign earnings. As a result of recent changes in U.S. tax legislation, any repatriation of these earnings would not result in additional U.S. federal income tax.

We are subject to income tax in the United States and numerous foreign jurisdictions. Significant judgment is required in evaluating our tax positions and determining our provision for income taxes. During the ordinary course of business, there are many transactions and calculations for which the ultimate tax determination is uncertain. We establish reserves for tax-related uncertainties based on estimates of whether, and the extent to which, additional taxes will be due. These reserves are established when we believe that certain positions might be challenged despite our belief that our tax return positions are fully supportable. We adjust these reserves in light of changing facts and circumstances, such as the outcome of tax audits. The provision for income taxes includes the impact of reserve positions and changes to reserves that are considered appropriate.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

	Total (in thousands)
Unrecognized tax benefits at January 1, 2016	$ 54,880
Gross increase to positions in prior years	1,164
Gross decrease to positions in prior years	(612)
Gross increases to current period tax positions	5,071
Audit settlements	(1,116)
Decrease related to lapsing of statute of limitations	(860)
Effect of change in exchange rates	(901)
Unrecognized tax benefits at December 31, 2016	$ 57,626
Gross increase to positions in prior years	3,367
Gross decrease to positions in prior years	(5,559)
Gross increases to current period tax positions	6,453
Audit settlements	(5,169)
Decrease related to lapsing of statute of limitations	(3,445)
Effect of change in exchange rates	3,429
Unrecognized tax benefits at December 31, 2017	$ 56,702
Gross increase to positions in prior years	22,943
Gross decrease to positions in prior years	(24,949)
Gross increases to current period tax positions	63,869
Audit settlements	(2,977)
Decrease related to lapsing of statute of limitations	(1,368)
Effect of change in exchange rates	(1,662)
Unrecognized tax benefits at December 31, 2018	$ 112,558

	At December 31,		
	2018	**2017**	**2016**
	(in thousands)		

The amount of unrecognized tax benefits that, if recognized, would affect our effective tax rate	$111,224	$55,312	$56,411

If certain unrecognized tax benefits are recognized they would create additional deferred tax assets. These assets would require a full valuation allowance in certain locations based upon present circumstances.

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We classify interest expense and penalties related to unrecognized tax benefits and interest income on tax overpayments as components of income tax expense. The net interest and penalties expense recognized is as follows:

	Year Ended December 31,		
	2018	2017	2016
	(in thousands)		
Net interest and penalties expense (benefit)	$ (990)	$ (543)	$ 193

	At December 31,	
	2018	2017
	(in thousands)	
Accrued interest	$ 2,127	$ 2,706
Accrued penalties	1,758	2,426

At December 31, 2018, we are under examination by certain tax authorities for the 2010 to 2017 tax years. The material jurisdictions where we are subject to examination for the 2010 to 2017 tax years include, among others, the U.S., France, Germany, Italy, Brazil and the United Kingdom. During December 2018 we settled our tax audit with the Internal Revenue Service for the 2014-2015 years and we settled our tax audit with Germany for the 2011-2013 years. We believe we have appropriately accrued for the expected outcome of all tax matters and do not currently anticipate that the ultimate resolution of these examinations will have a material adverse effect on our financial condition, future results of operations, or cash flows.

Based upon the timing and outcome of examinations, litigation, the impact of legislative, regulatory, and judicial developments, and the impact of these items on the statute of limitations, it is reasonably possible that the related unrecognized tax benefits could change from those recognized within the next twelve months. However, at this time, an estimate of the range of reasonably possible adjustments to the balance of unrecognized tax benefits cannot be made.

We file income tax returns in the U.S. federal jurisdiction and various states and foreign jurisdictions. We are subject to income tax examination by tax authorities in our major tax jurisdictions as follows:

Tax Jurisdiction	Years Subject to Audit
U.S. federal	Subsequent to 2001
France	Subsequent to 2012
Germany	Subsequent to 2013
Brazil	Subsequent to 2012
United Kingdom	Subsequent to 2013
Italy	Subsequent to 2013

Note 12: Commitments and Contingencies

Commitments

Operating lease rental expense for factories, service and distribution locations, offices, and equipment was as follows:

Year Ended December 31,		
2018	2017	2016
(in thousands)		

Rental expense	$24,453	$14,824	$14,232

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Future minimum lease payments at December 31, 2018, under noncancelable operating leases with initial or remaining terms in excess of one year are as follows:

Year Ending December 31,	**Minimum Payments**
	(in thousands)
2019	$ 17,456
2020	14,234
2021	12,007
2022	9,764
2023	9,895
Beyond 2023	26,703
Future minimum lease payments	$ 90,059

Rent expense is recognized straight-line over the lease term, including renewal periods if reasonably assured. We lease most of our sales and distribution locations and administrative offices. Our leases typically contain renewal options similar to the original terms with lease payments that increase based on an index.

Guarantees and Indemnifications

We are often required to obtain standby letters of credit (LOCs) or bonds in support of our obligations for customer contracts. These standby LOCs or bonds typically provide a guarantee to the customer for future performance, which usually covers the installation phase of a contract and may, on occasion, cover the operations and maintenance phase of outsourcing contracts.

Our available lines of credit, outstanding standby LOCs, and bonds are as follows:

	At December 31,	
	2018	**2017**
	(in thousands)	
Credit facilities[1]		
Multicurrency revolving line of credit	$500,000	$500,000
Long-term borrowings	—	(125,414)
Standby LOCs issued and outstanding	(40,983)	(31,881)
Net available for additional borrowings under the multi-currency revolving line of credit	$459,017	$342,705
Net available for additional standby LOCs under sub-facility	$259,017	$218,119
Unsecured multicurrency revolving lines of credit with various financial institutions		
Multicurrency revolving line of credit	$108,039	$110,477
Standby LOCs issued and outstanding	(19,386)	(21,030)
Short-term borrowings[2]	(2,232)	(916)
Net available for additional borrowings and LOCs	$86,421	$88,531
Unsecured surety bonds in force	$94,365	$51,344

(1) Refer to "Note 6: Debt" for details regarding our secured credit facilities, including the refinancing of the 2015 credit facility.

(2) Short-term borrowings are included in other current liabilities on the Consolidated Balance Sheets.

In the event any such standby LOC or bond is called, we would be obligated to reimburse the issuer of the standby LOC or bond; however, we do not believe that any outstanding LOC or bond will be called.

We generally provide an indemnification related to the infringement of any patent, copyright, trademark, or other intellectual property right on software or equipment within our sales contracts, which indemnifies the customer from and pays the resulting costs, damages, and attorney's fees awarded against a customer with respect to such a claim provided that (a) the customer promptly notifies us in writing of the claim and (b) we have the sole control of the defense and all related settlement negotiations. We may also provide an indemnification to our customers for third-party claims resulting from damages caused by the negligence or willful misconduct of our employees/agents in connection with the performance of certain contracts. The terms of our indemnifications generally do not limit the maximum potential payments. It is not possible to predict the maximum potential amount of future payments under these or similar agreements.

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Legal Matters

We are subject to various legal proceedings and claims of which the outcomes are subject to significant uncertainty. Our policy is to assess the likelihood of any adverse judgments or outcomes related to legal matters, as well as ranges of probable losses. A determination of the amount of the liability required, if any, for these contingencies is made after an analysis of each known issue. A liability is recognized and charged to operating expense when we determine that a loss is probable and the amount can be reasonably estimated. Additionally, we disclose contingencies for which a material loss is reasonably possible, but not probable.

Warranty

A summary of the warranty accrual account activity is as follows:

	Year Ended December 31,		
	2018	**2017**	**2016**
	(in thousands)		
Beginning balance	$34,862	$43,302	$54,512
Assumed liabilities from acquisition	12,946	—	—
New product warranties	3,772	7,849	7,987
Other adjustments and expirations, net	22,741	(393)	5,933
Claims activity	(12,753)	(18,094)	(24,364)
Effect of change in exchange rates	(1,125)	2,198	(766)
Ending balance	60,443	34,862	43,302
Less: current portion of warranty	47,205	21,150	24,874
Long-term warranty	$13,238	$13,712	$18,428

Total warranty expense is classified within cost of revenues and consists of new product warranties issued, costs related to insurance and supplier recoveries, and other changes and adjustments to warranties. Warranty expense was as follows:

	Year Ended December 31,		
	2018	**2017**	**2016**
	(in thousands)		
Total warranty expense (benefit)	$26,513	$(2,054)	$13,920

Warranty expense increased during the year ended December 31, 2018 compared with the same period in 2017. This increase is primarily driven by a warranty reserve of $11.4 million for replacement of certain gas meters in our Device Solutions segment in 2018, as well as an insurance recovery of $8.0 million received in 2017, which was associated with product replacement costs originally recognized in 2015.

Health Benefits

We are self-insured for a substantial portion of the cost of our U.S. employee group health insurance. We purchase insurance from a third-party, which provides individual and aggregate stop loss protection for these costs. Each reporting period, we expense the costs of our health insurance plan including paid claims, the change in the estimate of incurred but not reported (IBNR) claims, taxes, and administrative fees (collectively, the plan costs).

Plan costs were as follows:

Year Ended December 31,		
2018	**2017**	**2016**

	(in thousands)		
Plan costs	$41,543	$30,521	$27,276

IBNR accrual, which is included in wages and benefits payable, was as follows:

	At December 31,	
	2018	**2017**
	(in thousands)	
IBNR accrual	$3,643	$2,664

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Our IBNR accrual and expenses may fluctuate due to the number of plan participants, claims activity, and deductible limits. For our employees located outside of the United States, health benefits are provided primarily through governmental social plans, which are funded through employee and employer tax withholdings.

Note 13: Restructuring

2018 Projects

On February 22, 2018, our Board of Directors approved a restructuring plan (2018 Projects) to continue our efforts to optimize our global supply chain and manufacturing operations, research and development, and sales and marketing organizations. We expect to substantially complete the plan by the end of 2020. Many of the affected employees are represented by unions or works councils, which require consultation, and potential restructuring projects may be subject to regulatory approval, both of which could impact the timing of charges, total expected charges, cost recognized, and planned savings in certain jurisdictions.

The total expected restructuring costs, the restructuring costs and the remaining expected restructuring costs related to the 2018 Projects are as follows:

	Total Expected Costs at December 31, 2018	Costs Recognized in Prior Periods	Costs Recognized During the Year Ended December 31, 2018	Expected Remaining Costs to be Recognized at December 31, 2018
	(in thousands)			
Employee severance costs	$73,778	$ —	$ 73,778	$ —
Asset impairments & net gain on sale or disposal	117	—	117	—
Other restructuring costs	24,818	—	4,228	20,590
Total	$98,713	$ —	$ 78,123	$ 20,590

2016 Projects

On September 1, 2016, we announced projects (2016 Projects) to restructure various company activities in order to improve operational efficiencies, reduce expenses and improve competitiveness. We expect to close or consolidate several facilities and reduce our global workforce as a result of the restructuring. The 2016 Projects were initiated during the third quarter of 2016 and were substantially complete as of December 31, 2018.

The total expected restructuring costs, the restructuring costs recognized, and the remaining expected restructuring costs related to the 2016 Projects are as follows:

	Total Expected Costs at December 31, 2018	Costs Recognized in Prior Periods	Costs Recognized During the Year Ended December 31, 2018	Expected Remaining Costs to be Recognized at December 31, 2018
	(in thousands)			
Employee severance costs	$35,845	$ 39,855	$ (4,010)	$ —
Asset impairments & net loss on sale or disposal	5,664	4,922	742	—
Other restructuring costs	12,913	9,435	2,328	1,150
Total	$54,422	$ 54,212	$ (940)	$ 1,150

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The following table summarizes the activity within the restructuring related balance sheet accounts for the 2018 and 2016 Projects during the year ended December 31, 2018:

	Accrued Employee Severance	Asset Impairments & Net Gain on Sale or Disposal	Other Accrued Costs	Total
	(in thousands)			
Beginning balance, January 1, 2018	$37,654	$ —	$2,471	$40,125
Costs charged to expense	69,768	859	6,556	77,183
Cash (payments) receipts	(28,894)	42	(5,610)	(34,462)
Net assets disposed and impaired	—	(901)	—	(901)
Effect of change in exchange rates	(6,376)	—	(1)	(6,377)
Ending balance, December 31, 2018	$72,152	$ —	$3,416	$75,568

Asset impairments are determined at the asset group level. Revenues and net operating income from the activities we have exited or will exit under the restructuring projects are not material to our operating segments or consolidated results.

Other restructuring costs include expenses for employee relocation, professional fees associated with employee severance, and costs to exit the facilities once the operations in those facilities have ceased. Costs associated with restructuring activities are generally presented in the Consolidated Statements of Operations as restructuring, except for certain costs associated with inventory write-downs, which are classified within cost of revenues, and accelerated depreciation expense, which is recognized according to the use of the asset.

The current portion of restructuring liabilities were $36.0 million and $32.5 million as of December 31, 2018 and 2017, respectively. The current portion of restructuring liabilities are classified within other current liabilities on the Consolidated Balance Sheets. The long-term portion of restructuring liabilities balances were $39.6 million and $7.6 million as of December 31, 2018 and 2017, respectively. The long-term portion of restructuring liabilities are classified within other long-term obligations on the Consolidated Balance Sheets, and include severance accruals and facility exit costs.

Following our operational reorganization, effective October 1, 2018, we no longer allocate restructuring costs to our operating segments. All such costs are recognized within the Corporate unallocated reporting segment.

Note 14: Shareholders' Equity

Preferred Stock

We have authorized the issuance of 10 million shares of preferred stock with no par value. In the event of a liquidation, dissolution, or winding up of the affairs of the corporation, whether voluntary or involuntary, the holders of any outstanding preferred stock will be entitled to be paid a preferential amount per share to be determined by our Board of Directors prior to any payment to holders of common stock. There was no preferred stock issued or outstanding at December 31, 2018, 2017, and 2016.

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Other Comprehensive Income (Loss)

The changes in the components of AOCI, net of tax, were as follows:

	Foreign Currency Translation Adjustments	Net Unrealized Gain (Loss) on Derivative Instruments	Net Unrealized Gain (Loss) on Nonderivative Instruments	Pension Benefit Obligation Adjustments	Accumulated Other Comprehensive Income (Loss)
	(in thousands)				
Balances at January 1, 2016	$(158,009)	$ 318	$ (14,380)	$ (28,536)	$ (200,607)
OCI before reclassifications	(23,570)	(1,087)	—	(6,191)	(30,848)
Amounts reclassified from AOCI	(1,407)	812	—	2,723	2,128
Total other comprehensive income (loss)	(24,977)	(275)	—	(3,468)	(28,720)
Balances at December 31, 2016	$(182,986)	$ 43	$ (14,380)	$ (32,004)	$ (229,327)
OCI before reclassifications	53,854	360	—	2,354	56,568
Amounts reclassified from AOCI	484	563	—	1,234	2,281
Total other comprehensive income (loss)	54,338	923	—	3,588	58,849
Balances at December 31, 2017	$(128,648)	$ 966	$ (14,380)	$ (28,416)	$ (170,478)
OCI before reclassifications	(28,841)	2,586	—	1,653	(24,602)
Amounts reclassified from AOCI	—	(2,351)	—	1,126	(1,225)
Total other comprehensive income (loss)	(28,841)	235	—	2,779	(25,827)
Balances at December 31, 2018	$(157,489)	$ 1,201	$ (14,380)	$ (25,637)	$ (196,305)

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The before-tax, income tax (provision) benefit, and net-of-tax amounts related to each component of OCI during the reporting periods were as follows:

	Year Ended December 31,		
	2018	2017	2016
	(in thousands)		
Before-tax amount			
Foreign currency translation adjustment	$(29,130)	$54,218	$(23,280)
Foreign currency translation adjustment reclassified into net income on disposal	—	484	(1,407)
Net unrealized gain (loss) on derivative instruments designated as cash flow hedges	2,908	585	(1,768)
Net hedging (gain) loss reclassified to net income	(2,507)	916	1,322
Net unrealized gain (loss) on defined benefit plans	2,343	3,401	(6,256)
Net defined benefit plan loss reclassified to net income	1,596	1,782	2,752
Total other comprehensive income (loss), before tax	(24,790)	61,386	(28,637)
Tax (provision) benefit			
Foreign currency translation adjustment	289	(364)	(290)
Net unrealized gain (loss) on derivative instruments designated as cash flow hedges	(322)	(225)	681
Net hedging (gain) loss reclassified into net income	156	(353)	(510)
Net unrealized gain (loss) on defined benefit plans	(690)	(1,047)	65
Net defined benefit plan loss reclassified to net income	(470)	(548)	(29)
Total other comprehensive income (loss) tax (provision) benefit	(1,037)	(2,537)	(83)
Net-of-tax amount			
Foreign currency translation adjustment	(28,841)	53,854	(23,570)
Foreign currency translation adjustment reclassified into net income on disposal	—	484	(1,407)
Net unrealized gain (loss) on derivative instruments designated as cash flow hedges	2,586	360	(1,087)
Net hedging (gain) loss reclassified into net income	(2,351)	563	812
Net unrealized gain (loss) on defined benefit plans	1,653	2,354	(6,191)
Net defined benefit plan loss reclassified to net income	1,126	1,234	2,723
Total other comprehensive income (loss), net of tax	$(25,827)	$58,849	$(28,720)

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Note 15: Fair Values of Financial Instruments

The fair values at December 31, 2018 and 2017 do not reflect subsequent changes in the economy, interest rates, tax rates, and other variables that may affect the determination of fair value.

	December 31, 2018		**December 31, 2017**	
	Carrying Amount	**Fair Value**	**Carrying Amount**	**Fair Value**
		(in thousands)		
Assets				
Cash and cash equivalents	$120,221	$120,221	$176,274	$176,274
Restricted cash	2,107	2,107	311,061	311,061
Foreign exchange forwards	157	157	41	41
Interest rate swaps	2,612	2,612	2,370	2,370
Interest rate caps	786	786	489	489
Cross currency swaps	2,970	2,970	—	—
Liabilities				
Credit facility				
USD denominated term loan	$637,813	$630,971	$194,063	$192,295
Multicurrency revolving line of credit	—	—	125,414	124,100
Senior notes	400,000	368,000	300,000	301,125
Foreign exchange forwards	337	337	289	289

The following methods and assumptions were used in estimating fair values:
Cash, cash equivalents, and restricted cash: Due to the liquid nature of these instruments, the carrying value approximates fair value (Level 1).

Credit Facility - term loan and multicurrency revolving line of credit: The term loan and revolver are not traded publicly. The fair values, which are determined based upon a hypothetical market participant, are calculated using a discounted cash flow model with Level 2 inputs, including estimates of incremental borrowing rates for debt with similar terms, maturities, and credit profiles. Refer to "Note 6: Debt" for a further discussion of our debt.
Derivatives: See "Note 7: Derivative Financial Instruments" for a description of our methods and assumptions in determining the fair value of our derivatives, which were determined using Level 2 inputs.
Senior Notes: The Notes are not registered securities nor listed on any securities exchange, but may be actively traded by qualified institutional buyers. The fair value is estimated using Level 1 inputs, as it is based on quoted prices for these instruments in active markets.

Note 16: Segment Information

Through September 30, 2018, we operated under the Itron brand worldwide and managed and reported under four operating segments: Electricity, Gas, Water, and Networks. Our Water operating segment included our global water, and heat and allocation solutions. Networks became a new operating segment with the acquisition of SSNI in January 2018. Our sales and marketing function was managed under each operating segment. Our research and development, service delivery, and manufacturing operations were managed on a worldwide basis to promote a global perspective in our operations and processes and yet still maintained alignment with the operating segments.

Effective October 1, 2018, we reorganized our operational reporting segmentation from Electricity, Gas, Water, and Networks to Device Solutions, Networked Solutions, and Outcomes. Prior period segment results have been recast to conform to the new segment structure. As part of our reorganization, we actively integrated our recent acquisitions and are making investment decisions and implementing an organizational structure that aligns with these new segments. In conjunction with the rollout of our new operating segments, we unified our go-to-market strategy with a single, global, sales force that sells the full portfolio of Itron solutions, products and services. We continue to manage our product development, service delivery, supply chain, and manufacturing operations on a worldwide basis to promote global, integrated oversight of our operations and to ensure consistency and interoperability between our operating segments.

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With this reorganization, we will continue to operate under the Itron brand worldwide and will manage and report under the three operating segments: Device Solutions, Networked Solutions, and Outcomes.

We have three GAAP measures of segment performance: revenues, gross profit (gross margin), and operating income (operating margin). Intersegment revenues are minimal. Certain operating expenses are allocated to the operating segments based upon internally established allocation methodologies. Corporate operating expenses, interest income, interest expense, other income (expense), and income tax provision are neither allocated to the segments, nor are they included in the measure of segment profit or loss. In addition, we allocate only certain production assets and intangible assets to our operating segments. We do not manage the performance of the segments on a balance sheet basis.

Segment Products

Device Solutions	Device Solutions - includes hardware products used for measurement, control, or sensing that do not have communications capability embedded for use with our broader Itron systems, i.e., products where Itron is not offering the complete "end-to-end" solution, but only the hardware elements. Examples of the Device Solutions portfolio include basic meters that are shipped without Itron communications, such as our standard gas meters, electricity IEC meters, and water meters, in addition to our heat and allocation products; communicating meters that are not a part of an Itron solution such as the Linky meter; and the implementation and installation of non-communicating devices, such as gas regulators.
Networked Solutions	Networked Solutions - includes a combination of communicating devices (smart meters, modules, endpoints, and sensors), network infrastructure, and associated application software designed and sold as a complete solution for acquiring and transporting robust application-specific data. Networked Solutions combines, into one operating segment, the majority of the assets from the recently acquired SSNI organization with our legacy Itron networking products and software and the implementation and installation of communicating devices into one segment. This includes: communicating measurement, control, or sensing endpoints such as our Itron® and OpenWay® Riva meters, Itron traditional ERT® technology, Intelis smart gas or water meters, 500G gas communication modules, 500W water communication modules; GenX networking products, network modules and interface cards; and specific network control and management software applications. Solutions supported by this segment include automated meter reading (AMR), advanced metering infrastructure (AMI), smart grid and distribution automation (DA), and smart street lighting and smart city solutions.
Outcomes	Outcomes - includes our value-added, enhanced software and services operating segment in which we manage, organize, analyze, and interpret data to improve decision making, maximize operational profitability, drive resource efficiency, and deliver results for consumers, utilities, and smart cities. Outcomes places an emphasis on delivering to Itron customers high-value, turn-key, digital experiences by leveraging the footprint of our Device Solutions and Networked Solutions segments. The revenues from these offerings are primarily recurring in nature and would include any direct management of Device Solutions, Networked Solutions, and other products on behalf of our end customers. Examples of these offerings include our meter data management and analytics offerings; our managed service solutions including network-as-a-service and platform-as-a-service, forecasting software and services; and any consulting-based engagement. Within the Outcomes segment, we also identify new business models, including performance-based contracting, to drive broader portfolio offerings across utilities and cities.

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Revenues, gross profit, and operating income associated with our segments were as follows:

	Year Ended December 31,		
	2018	2017	2016
	(in thousands)		
Product revenues			
Device Solutions	$916,809	$866,028	$894,583
Networked Solutions	1,133,919	881,042	882,097
Outcomes	44,730	66,855	53,390
Total Company	$2,095,458	$1,813,925	$1,830,070
Service revenues			
Device Solutions	$16,556	$16,868	$18,938
Networked Solutions	90,225	66,342	57,584
Outcomes	173,878	121,062	106,594
Total Company	$280,659	$204,272	$183,116
Total revenues			
Device Solutions	$933,365	$882,896	$913,521
Networked Solutions	1,224,144	947,384	939,681
Outcomes	218,608	187,917	159,984
Total Company	$2,376,117	$2,018,197	$2,013,186
Gross profit			
Device Solutions	$187,254	$216,631	$232,896
Networked Solutions	482,471	412,375	378,382
Outcomes	60,594	47,745	51,254
Total Company	$730,319	$676,751	$662,532
Operating income			
Device Solutions	$130,988	$159,641	$178,161
Networked Solutions	360,779	322,367	291,235
Outcomes	16,634	4,915	16,239
Corporate unallocated	(558,093)	(332,046)	(384,642)
Total Company	(49,692)	154,877	100,993
Total other income (expense)	(59,459)	(20,302)	(16,366)
Income (loss) before income taxes	$(109,151)	$134,575	$84,627

During the year ended December 31, 2017, we recognized an insurance recovery associated with warranty expenses previously recognized as a result of our 2015 product replacement notification. As a result, gross profit increased $8.0 million for the year ended December 31, 2017. After adjusting for the tax impact, the recovery resulted in an increase of $0.13 and $0.12 for basic and diluted EPS, respectively, for the year ended December 31, 2017.

For all periods presented, no single customer represents more than 10% of total Company.

Revenues by region were as follows:

Year Ended December 31,		
2018	2017	2016

	(in thousands)		
United States and Canada	$1,442,792	$1,137,508	$1,126,787
Europe, Middle East, and Africa (EMEA)	733,732	672,942	698,106
Other	199,593	207,747	188,293
Total Company	$2,376,117	$2,018,197	$2,013,186

Regional revenues as reported are based on the location of the selling entity.

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Property, plant, and equipment, net, by geographic area were as follows:

	At December 31,	
	2018	2017
	(in thousands)	
United States	$93,034	$67,764
Outside United States	133,517	133,004
Total Company	$226,551	$200,768

Depreciation expense is allocated to the operating segments based upon each segments use of the assets. All amortization expense is included in Corporate unallocated. Depreciation and amortization expense was as follows:

	Year Ended December 31,		
	2018	2017	2016
	(in thousands)		
Device Solutions	$25,022	$25,757	$25,158
Networked Solutions	12,671	7,758	9,137
Outcomes	6,572	3,826	3,041
Corporate unallocated	78,232	25,874	30,982
Total Company	$122,497	$63,215	$68,318

Note 17: Business Combinations

Silver Spring Networks, Inc.

On January 5, 2018, we completed the acquisition of SSNI by purchasing 100% of SSNI's outstanding stock. The acquisition was financed through incremental borrowings and cash on hand. Refer to "Note 6: Debt" for further discussion of our debt.

SSNI provided smart network and data platform solutions for electricity, gas, water and smart cities including advanced metering, distribution automation, demand-side management, and street lights. Solutions include one or several of the following: communications modules, access points, relays and bridges; network operating software, grid management, security and grid analytics managed services and SaaS; installation; implementation; and professional services including consulting and analysis. Upon acquisition, SSNI changed its name to Itron Networked Solutions, Inc. (INS), and initially operated separately as our Networks operating segment. Subsequent to the October 1, 2018 reorganization, the prior Networks operating segment was integrated into the new Networked Solutions and Outcomes operating segments.

The purchase price of SSNI was $809.2 million, which is net of $97.8 million of acquired cash and cash equivalents. Of the total consideration $802.5 million was paid in cash. The remaining $6.7 million relates to the fair value of pre-acquisition service for replacement awards of unvested SSNI options and restricted stock unit awards with an Itron equivalent award. We allocated the purchase price to the assets acquired and liabilities assumed based on estimated fair value assessments.

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The following reflects our allocation of purchase price:

	Fair Value (in thousands)	Weighted Average Useful Life (in years)
Current Assets	$ 86,701	
Property, plant, and equipment	27,670	6
Other long-term assets	3,866	
Identifiable intangible assets		
Core-developed technology	81,900	5
Customer contracts and relationships	134,000	10
Trademark and trade names	10,800	3
Total identified intangible assets subject to amortization	226,700	8
In-process research and development (IPR&D)	14,400	
Total identified intangible assets	241,100	
Goodwill	575,750	
Current liabilities	(99,406)	
Customer contracts and relationships	(23,900)	5
Long-term liabilities	(2,565)	
Total net assets acquired	$ 809,216	

The fair values for the identified trademarks and core-developed technology intangible assets were estimated using the relief from royalty method, which values the assets by estimating the savings achieved by ownership of trademark or technology when compared with the cost of licensing it from an independent owner.

The fair value of customer contracts and relationship were estimated using the income approach. Under the income approach, the fair value reflects the present value of the projected cash flows that are expected to be generated. The fair value of IPR&D was valued utilizing the replacement cost method, which measures the value of an asset based on the cost to replace the existing asset.
We estimated it would take approximately one year to complete the in-process technology. A profit mark-up was used to account for the return that a third-party developer would require on development efforts for the asset based on expected earnings before interest and taxes, and a return of ten percent was used based on the risk of the asset relative to the overall business. IPR&D will be amortized using the straight-line method after the technology is fully developed and is considered a product offering. Incremental costs to be incurred for these projects will be recognized as product development expense as incurred within the Consolidated Statements of Operations.

Core-developed technology represents the fair values of SSNI products that have reached technological feasibility and were part of SSNI's product offerings at the date of the acquisition. Customer contracts and relationships represent the fair value of the relationships developed with its customers, including the backlog. The core-developed technology, trademarks, and customer contracts and relationships intangible assets valued using the income approach will be amortized using the estimated discounted cash flows assumed in the valuation models.

Goodwill of $575.8 million arising from the acquisition consists largely of the synergies expected from combining the operations of Itron and SSNI, as well as certain intangible assets that do not qualify for separate recognition. All of the goodwill balance was assigned to the prior Networks reporting unit and operating segment. Refer to "Note 5: Goodwill". We will not be able to deduct any of the goodwill balance for income tax purposes.

As a part of the business combination, we have incurred $15.6 million of acquisition related expenses for the year ended December 31, 2018, which includes such activities as success fees, certain consulting and advisory costs, and incremental legal and accounting costs. In addition, for the year ended December 31, 2018, we recognized $76.3 million of integration costs, which are expenses related to integrating SSNI into Itron, and includes expenses such as accounting and process integration and the related consulting fees, severance, site closure costs, system integration, and travel associated with knowledge transfers as we consolidate redundant positions. All acquisition and integration related expenses are included within sales, general and administrative expenses in the Consolidated Statements of Operations.

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The following table presents the revenues and net loss from SSNI operations that are included in our Consolidated Statements of Operations:

	January 5, 2018 - December 31, 2018 (in thousands)
Revenues	$ 352,996
Net income (loss)	(54,409)

The following supplemental pro forma results (unaudited) are based on the individual historical results of Itron and SSNI, with adjustments to give effect to the combined operations as if the acquisition had been consummated on January 1, 2017.

	Year Ended December 31, 2018	2017
	(in thousands)	
Revenues	$ 2,376,117	$ 2,591,211
Net income (loss)	(84,602)	27,289

The significant nonrecurring adjustments reflected in the proforma schedule above are considered material and include the following:

- Elimination of transaction costs incurred by SSNI and Itron prior to the acquisition completion
- Reclassification of certain expenses incurred after the acquisition to the appropriate periods assuming the acquisition closed on January 1, 2017

The supplemental pro forma results are intended for information purposes only and do not purport to represent what the combined companies' results of operations would actually have been had the transaction in fact occurred at an earlier date or project the results for any future date or period.

Note 18: Revenues

A summary of significant net changes in the contract assets and the contract liabilities balances during the period is as follows:

	2018 Net contract liabilities, less contract assets (in thousands)
Beginning balance, January 1	$ 59,808
Changes due to business combination	36,936
Revenues recognized from beginning contract liability	(32,821)
Increases due to amounts collected or due	282,016
Revenues recognized from current period increases	(241,510)

Other	(2,299)
Ending balance, December 31	$ 102,130

On January 1, 2018, total contract assets were $11.3 million and total contract liabilities were $71.1 million. On December 31, 2018, total contract assets were $34.3 million and total contract liabilities were $136.5 million. The contract assets primarily relate to contracts that include a retention clause and allocations related to contracts with multiple performance obligations. The contract liabilities primarily relate to deferred revenue, such as extended warranty and maintenance cost, and allocations related to contracts with multiple performance obligations. During the three months ended December 31, 2018, revenue recognized of $1.1 million was related to amounts that was included as a contract liability at January 1, 2018.

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Transaction price allocated to the remaining performance obligations

Total transaction price allocated to remaining performance obligations represent committed but undelivered products and services for contracts and purchase orders at period end. Twelve-month remaining performance obligations represent the portion of total transaction price allocated to remaining performance obligations that we estimate will be recognized as revenue over the next 12 months. Total transaction price allocated to remaining performance obligations is not a complete measure of our future revenues as we also receive orders where the customer may have legal termination rights but are not likely to terminate.

Total transaction price allocated to remaining performance obligations related to contracts is approximately $1.2 billion for the next twelve months and approximately $885 million for periods longer than 12 months. The total remaining performance obligations is comprised of product and service components. The service component relates primarily to maintenance agreements for which customers pay a full year's maintenance in advance, and service revenues are generally recognized over the service period. Total transaction price allocated to remaining performance obligations also includes our extended warranty contracts, for which revenue is recognized over the warranty period, and hardware, which is recognized as units are delivered. The estimate of when remaining performance obligations will be recognized requires significant judgment.

Cost to obtain a contract and cost to fulfill a contract with a customer

Cost to obtain a contract and costs to fulfill a contract were capitalized and amortized using a systematic rational approached to align with the transfer of control of underlying contracts with customers. While amounts were capitalized, amounts are not material for disclosure.

Disaggregation of revenue

Refer to "Note 16: Segment Information" and the Consolidated Statements of Operations for disclosure regarding the disaggregation of revenue into categories which depict how revenue and cash flows are affected by economic factors. Specifically, our operating segments and geographical regions as disclosed, and categories for products, which include hardware and software and services as presented.

Impacts on financial statements

Under the modified retrospective transition method, we are required to provide additional disclosures during 2018 of the amount by which each financial statement line item is affected in the current reporting period, as compared with the guidance that was in effect before the change, and an explanation of the reasons for significant changes, if any. The cumulative impact of adoption of ASC 606 and ASC 340-40 on our Consolidated Balance Sheets was a net decrease to accumulated deficit of $10.9 million as of January 1, 2018.

The effect of ASC 606 and Subtopic ASC 340-40 on our Consolidated Statements of Operations for the year ended December 31, 2018 was total revenue would have been $25.9 million lower under ASC 605. The difference in total revenue reflects the timing of revenue recognition due to the treatment of software license revenue under ASC 606 and other performance obligations that were satisfied but the right to consideration is conditional. The impact of the adoption was not material to the other lines in the Consolidated Statements of Operations.

The effects of ASC 606 and Subtopic ASC 340-40 on our Consolidated Balance Sheets as of December 31, 2018 were an impact to other current assets, unearned revenue, and accumulated deficit. Under ASC 605 other current assets would have been lower by $21.0 million. The difference in other current assets reflects the timing of satisfying performance obligations prior to invoicing, but the right to consideration is conditional. Total unearned revenue would have been higher by $22.2 million, of which, $8.9 million would have been classified as current. The difference in unearned revenue reflects the timing of revenue recognition related to certain of our customer contracts. The cumulative impact of ASC 606 as of December 31, 2018 was a net decrease to our accumulated deficit of $36.7 million.

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Note 19: Quarterly Results (Unaudited)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total Year
	(in thousands, except per share data)				
2018					
Statement of operations data:					
Revenues	$607,221	$585,890	$595,962	$587,044	$2,376,117
Gross profit	179,855	176,577	197,097	176,790	730,319
Net income (loss) attributable to Itron, Inc.	(145,666)	2,657	19,882	23,877	(99,250)
Earnings (loss) per common share - Basic[(1)]	$(3.74)	$0.07	$0.51	$0.61	$(2.53)
Earnings (loss) per common share - Diluted[(1)]	$(3.74)	$0.07	$0.50	$0.60	$(2.53)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total Year
	(in thousands, except per share data)				
2017					
Statement of operations data:					
Revenues	$477,592	$503,082	$486,747	$550,776	$2,018,197
Gross profit	157,637	178,277	165,755	175,082	676,751
Net income attributable to Itron, Inc.	15,845	14,097	25,576	1,780	57,298
Earnings per common share - Basic[(1)]	$0.41	$0.36	$0.66	$0.05	$1.48
Earnings per common share - Diluted[(1)]	$0.40	$0.36	$0.65	$0.05	$1.45

(1) The sum of the quarterly EPS data presented in the table may not equal the annual results due to rounding and the impact of dilutive securities on the annual versus the quarterly EPS calculations.

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ITEM 9: CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

There were no disagreements with our independent accountants on accounting and financial disclosure matters within the three year period ended December 31, 2018, or in any period subsequent to such date, through the date of this report.

ITEM 9A: CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures

An evaluation was performed under the supervision and with the participation of our Company's management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e)) under the Securities Exchange Act of 1934 as amended. Based on that evaluation, the Company's management, including the Chief Executive Officer and Chief Financial Officer, concluded that as of December 31, 2018, the Company's disclosure controls and procedures were effective to ensure the information required to be disclosed by an issuer in the reports that it files or submits under the Securities Exchange Act of 1934 is accumulated and communicated to our management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives.

Management's Annual Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f). Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control— Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 Framework). Based on our evaluation under the 2013 Framework, management concluded that our internal control over financial reporting was effective as of December 31, 2018.

On January 5, 2018, we completed the acquisition of Silver Spring Networks, Inc. (SSNI). For further discussion of the SSNI acquisition, refer to Item 8: "Financial Statements and Supplementary Data, Note 17: Business Combinations". The Securities and Exchange Commission permits companies to exclude acquisitions from their assessment of internal control over financial reporting during the first year of an acquisition, and our management has elected to exclude SSNI from our assessment as of December 31, 2018, except for goodwill, intangible assets, and controls implemented in 2018 to remediate a material weakness in revenue recognition reported by SSNI prior to our acquisition. SSNI contributed 9% and 15% of our consolidated total assets (excluding goodwill and intangible assets) and revenues as of and for the year ended December 31, 2018, respectively.

The effectiveness of our internal control over financial reporting as of December 31, 2018 has been audited by Deloitte & Touche LLP, an independent registered public accounting firm, as stated in their report that is included in this Annual Report.

Changes in internal control over financial reporting

In the ordinary course of business, we review our system of internal control over financial reporting and make changes to our applications and processes to improve such controls and increase efficiency, while ensuring that we maintain an effective internal control environment. Changes may include such activities as implementing new, more efficient applications and automating manual processes. We are currently upgrading our global enterprise resource software applications at certain of our locations outside of the United States as well as locations acquired through acquisitions.

We will continue to upgrade our financial applications in stages, and we believe the related changes to processes and internal controls will allow us to be more efficient and further enhance our internal control over financial reporting.
As described in Item 8; "Financial Statements and Supplementary Data, Note 1: Summary of Significant Accounting Policies", we adopted Accounting Standards Update (ASU) 2016-02, *Leases (Topic 842)* effective January 1, 2019. As we complete the adoption and implementation of this new leasing standard during the first quarter of 2019, we have modified certain internal controls over financial reporting to address risks associated with the required lease accounting and disclosure requirements. This includes enhancing controls to address risks associated with calculating the right-of-use asset and corresponding lease liability for each lease and with the implementation of a new computer system to track our leasing portfolio, process accounting transactions,

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and report on activity and balances. Additional controls will be implemented as deemed necessary for ongoing lease accounting under ASU 2016-02.

Except for these changes, there have been no other changes in our internal control over financial reporting during the three months ended December 31, 2018 that materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the shareholders and the Board of Directors of Itron, Inc.

Opinion on Internal Control over Financial Reporting

We have audited the internal control over financial reporting of Itron, Inc. and subsidiaries (the "Company") as of December 31, 2018, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by COSO.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB) the consolidated financial statements as of and for the year ended December 31, 2018, of the Company and our report dated February 28, 2019, expressed an unqualified opinion on those financial statements and included an explanatory paragraph relating to the Company's adoption of ASC 606, *Revenue from Contracts with Customers*.

As described in *Management's Annual Report on Internal Control Over Financial Reporting*, management excluded from its assessment the internal control over financial reporting at Silver Spring Networks, Inc. (SSNI), except for goodwill, intangible assets and controls implemented in 2018 to remediate a material weakness in revenue recognition reported by SSNI prior to its acquisition. SSNI was acquired on January 5, 2018 and its financial statements, excluding goodwill and intangible assets, constitute 9% and 15% of consolidated total assets and revenues, respectively, as of and for the year ended December 31, 2018. Accordingly, our audit did not include the internal control over financial reporting at SSNI, except for goodwill, intangible assets, and controls implemented in 2018 to remediate a material weakness in revenue recognition reported by SSNI prior to its acquisition.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying *Management's Annual Report on Internal Control Over Financial Reporting*. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control over Financial Reporting

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

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may

deteriorate.
/s/ DELOITTE & TOUCHE LLP
Seattle, Washington
February 28, 2019

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ITEM 9B: OTHER INFORMATION

No information was required to be disclosed in a report on Form 8-K during the fourth quarter of 2018 that was not reported.

PART III
ITEM 10: DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The section entitled "Proposal 1 – Election of Directors" appearing in our Proxy Statement for the Annual Meeting of Shareholders to be held on May 9, 2019 (the 2019 Proxy Statement) sets forth certain information with regard to our directors as required by Item 401 of Regulation S-K and is incorporated herein by reference.

Certain information with respect to persons who are or may be deemed to be executive officers of Itron, Inc. as required by Item 401 of Regulation S-K is set forth under the caption "Executive Officers" in Part I of this Annual Report.

The section entitled "Section 16(a) Beneficial Ownership Reporting Compliance" appearing in the 2019 Proxy Statement sets forth certain information as required by Item 405 of Regulation S-K and is incorporated herein by reference.

The section entitled "Corporate Governance" appearing in the 2019 Proxy Statement sets forth certain information with respect to the Registrant's code of conduct and ethics as required by Item 406 of Regulation S-K and is incorporated herein by reference. Our code of conduct and ethics can be accessed on our website, at www.itron.com under the Investors section.

There were no material changes to the procedures by which security holders may recommend nominees to Itron's board of directors during 2019, as set forth by Item 407(c)(3) of Regulation S-K.

The section entitled "Corporate Governance" appearing in the 2019 Proxy Statement sets forth certain information regarding the Audit/Finance Committee, including the members of the Committee and the Audit/Finance Committee financial experts, as set forth by Item 407(d)(4) and (d)(5) of Regulation S-K and is incorporated herein by reference.

ITEM 11: EXECUTIVE COMPENSATION

The sections entitled "Compensation of Directors" and "Executive Compensation" appearing in the 2019 Proxy Statement set forth certain information with respect to the compensation of directors and management of Itron as required by Item 402 of Regulation S-K and are incorporated herein by reference.

The section entitled "Corporate Governance" appearing in the 2019 Proxy Statement sets forth certain information regarding members of the Compensation Committee required by Item 407(e)(4) of Regulation S-K and is incorporated herein by reference.

The section entitled "Compensation Committee Report" appearing in the 2019 Proxy Statement sets forth certain information required by Item 407(e)(5) of Regulation S-K and is incorporated herein by reference.

ITEM 12: SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The section entitled "Equity Compensation Plan Information" appearing in the 2019 Proxy Statement sets forth certain information required by Item 201(d) of Regulation S-K and is incorporated herein by reference.

The section entitled "Security Ownership of Certain Beneficial Owners and Management" appearing in the 2019 Proxy Statement sets forth certain information with respect to the ownership of our common stock as required by Item 403 of Regulation S-K and is incorporated herein by reference.

ITEM 13: CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The section entitled "Corporate Governance" appearing in the 2019 Proxy Statement sets forth certain information required by Item 404 of Regulation S-K and is incorporated herein by reference.

The section entitled "Corporate Governance" appearing in the 2019 Proxy Statement sets forth certain information with respect to director independence as required by Item 407(a) of Regulation S-K and is incorporated herein by reference.

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ITEM 14: PRINCIPAL ACCOUNTING FEES AND SERVICES

The section entitled "Independent Registered Public Accounting Firm's Audit Fees and Services" appearing in the 2019 Proxy Statement sets forth certain information with respect to the principal accounting fees and services and the Audit/Finance Committee's policy on pre-approval of audit and permissible non-audit services performed by our independent auditors as required by Item 9(e) of Schedule 14A and is incorporated herein by reference.

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PART IV
ITEM 15: EXHIBITS, FINANCIAL STATEMENT SCHEDULE

(a) (1) Financial Statements:
The financial statements required by this item are submitted in Item 8 of this Annual Report on Form 10-K.
(a) (2) Financial Statement Schedule:
All schedules have been omitted because of the absence of conditions under which they are required or because the required information is included in the consolidated financial statements or the notes thereto.

(a) (3) Exhibits:

Exhibit Number	Description of Exhibits
2.1	Agreement and Plan of Merger, dated September 17, 2017, by and among Itron, Inc., Ivory Merger Sub, Inc., and Silver Spring, Inc. (Filed as Exhibit 2.1 to Itron Inc.'s Current Report on Form 8-K, filed on September 18, 2017)
3.1	Amended and Restated Articles of Incorporation of Itron, Inc. (Filed as Exhibit 3.1 to Itron, Inc.’s Annual Report on Form 10-K, filed on March 27, 2003)
3.2	Amended and Restated Bylaws of Itron, Inc. (Filed as Exhibit 3.2 to Itron, Inc.'s Annual Report on Form 10-K, filed on June 30, 2016)
4.1	Security Agreement dated August 5, 2011 among Itron, Inc. and Wells Fargo Bank, National Association (Filed as Exhibit 4.2 to Form 8-K filed on August 8, 2011)
4.2	First Amendment to Security Agreement dated June 23, 2015 among Itron, Inc. and Wells Fargo Bank, National Association. (Filed as Exhibit 4.2 to Itron, Inc.’s Current Report on Form 8-K, filed on June 23, 2015)
4.3	Indenture, dated as of December 22, 2017 among Itron, Inc., the guarantors from time to time party thereto and U.S. Bank National Association, as trustee. (Filed as Exhibit 4.1 to Itron, Inc.'s Current Report on Form 8-K, filed on December 22, 2017)
4.4	Second Amended and Restated Credit Agreement dated January 5, 2018 among Itron, Inc. and a syndicate of banks led by Wells Fargo Bank, National Association, JPMorgan Chase Bank, N.A., J.P. Morgan Europe Limited, J.P. Morgan Securities PLC, BNP Paribas, and Silicon Valley Bank (Filed as Exhibit 4.1 to Itron, Inc.'s Current Report on Form 8-K, filed on January 11, 2018)
10.1*	Form of Amended and Restated Change in Control Severance Agreement for Executive Officers. (Filed as Exhibit 10.1 to Itron, Inc.’s Annual Report on Form 10-K, filed on February 22, 2013)
10.2*	Schedule of certain executive officers who are parties to Change in Control Severance Agreements with Itron, Inc. (filed with this report)
10.3*	Form of Indemnification Agreements between Itron, Inc. and certain directors and officers. (Filed as Exhibit 10.9 to Itron, Inc.’s Annual Report on Form 10-K, filed on March 30, 2000)

10.4*	Schedule of directors and executive officers who are parties to Indemnification Agreements with Itron, Inc. (filed with this report)
10.5*	Amended and Restated 2010 Stock Incentive Plan. (Filed as Appendix A to Itron, Inc.'s Proxy Statement for the 2014 Annual Meeting of Shareholders, filed on March 13, 2014)

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Exhibit Number	Description of Exhibits
10.6*	Second Amended and Restated 2010 Stock Incentive Plan. (Filed as Appendix A to Itron, Inc.'s Proxy Statement for the 2017 Annual Meeting of Shareholders, filed on March 24, 2017)
10.7*	Rules of Itron Inc.'s Amended and Restated 2010 Stock Incentive Plan for the Grant of Restricted Stock Unit (RSU's) to Participants in France. (Filed as Exhibit 10.6 to Itron, Inc.'s Quarterly Report on Form 10-Q, filed on August 6, 2014)
10.8*	Executive Management Incentive Plan. (Filed as Appendix B to Itron, Inc.’s Proxy Statement for the 2010 Annual Meeting of Shareholders, filed on March 17, 2010)
10.9*	Terms of the Amended and Restated Equity Grant Program for Nonemployee Directors under the Itron, Inc. Amended and Restated 2000 Stock Incentive Plan. (Filed as Exhibit 10.4 to Itron, Inc.’s Annual Report on Form 10-K, filed on February 26, 2008)
10.10*	Form of Stock Option Grant Notice and Agreement for use in connection with both incentive and non-qualified stock options granted under Itron, Inc.'s Amended and Restated 2000 Stock Incentive Plan. (Filed as Exhibit 10.6 to Itron, Inc.’s Current Report on Form 8-K, filed on February 18, 2010)
10.11*	Form of RSU Award Notice and Agreement for U.S. Participants for use in connection with the Company’s Long-Term Performance Plan (LTPP) and issued under Itron, Inc.'s Amended and Restated 2000 Stock Incentive Plan. (Filed as Exhibit 10.1 to Itron, Inc.’s Current Report on Form 8-K, filed on February 18, 2010)
10.12*	Form of RSU Award Notice and Agreement for International Participants (excluding France) for use in connection with the Company’s LTPP and issued under Itron, Inc.'s Amended and Restated 2000 Stock Incentive Plan. (Filed as Exhibit 10.2 to Itron, Inc.’s Current Report on Form 8-K, filed on February 18, 2010)
10.13*	Form of RSU Award Notice and Agreement for Participants in France for use in connection with Itron, Inc.'s LTPP and issued under Itron, Inc.'s Amended and Restated 2000 Stock Incentive Plan. (Filed as Exhibit 10.3 to Itron, Inc.’s Current Report on Form 8-K, filed on February 18, 2010)
10.14*	Form of RSU Award Notice and Agreement for all Participants (excluding France) for use in connection with Itron, Inc.'s Amended and Restated 2000 Stock Incentive Plan. (Filed as Exhibit 10.4 to Itron, Inc.’s Current Report on Form 8-K, filed on February 18, 2010)
10.15*	Form of RSU Award Notice and Agreement for Participants in France for use in connection with Itron, Inc.'s Amended and Restated 2000 Stock Incentive Plan. (Filed as Exhibit 10.5 to Itron, Inc.’s Current Report on Form 8-K, filed on February 18, 2010)
10.16*	Form of Long Term Performance RSU Award Notice and Agreement for U.S. Participants for use in connection with Itron, Inc.'s Amended and Restated 2010 Stock Incentive Plan. (Filed as Exhibit 10.4 to Itron, Inc.’s Quarterly Report on Form 10-Q, filed on August 6, 2014)
10.17*	

	Form of Long Term Performance RSU Award Notice and Agreement for International Participants (excluding France) for use in connection with Itron, Inc.'s Amended and Restated 2010 Stock Incentive Plan. (Filed as Exhibit 10.19 to Itron, Inc.’s Annual Report on Form 10-K, filed on February 25, 2011)
10.18*	Form of Long Term Performance RSU Award Notice and Agreement for Participants in France for use in connection with Itron, Inc.'s Amended and Restated 2010 Stock Incentive Plan. (Filed as Exhibit 10.5 to Itron, Inc.’s Quarterly Report on Form 10-Q, filed on August 6, 2014)
10.19*	Form of RSU Award Notice and Agreement for all Participants (excluding France) for use in connection with Itron, Inc.'s Amended and Restated 2010 Stock Incentive Plan. (Filed as Exhibit 10.2 to Itron, Inc.’s Quarterly Report on Form 10-Q, filed on August 6, 2014)
10.20*	Form of RSU Award Notice and Agreement for Participants in France for use in connection with Itron, Inc.'s Amended and Restated 2010 Stock Incentive Plan. (Filed as Exhibit 10.3 to Itron, Inc.’s Quarterly Report on Form 10-Q, filed on August 6, 2014)

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Exhibit Number	Description of Exhibits
10.21*	Form of RSU Award Notice and Agreement for Non-employee Directors for use in connection with Itron, Inc.'s Amended and Restated 2010 Stock Incentive Plan. (Filed as Exhibit 10.3 to Itron, Inc.’s Quarterly Report on Form 10-Q, filed on May 3, 2013)
10.22*	Form of Stock Option Grant Notice and Agreement for use in connection with both incentive and non-qualified stock options granted under Itron, Inc.'s Amended and Restated 2010 Stock Incentive Plan. (Filed as Exhibit 10.1 to Itron, Inc's Quarterly Report on Form 10-Q, filed on August 6, 2014)
10.23*	Amendment to the Executive Deferred Compensation Plan. (Filed as Exhibit 10.1 to Itron, Inc.’s Quarterly Report on Form 10-Q, filed on November 3, 2016)
10.24*	Amended and Restated 2002 Employee Stock Purchase Plan. (Filed as Exhibit 10.20 to Itron, Inc.’s Annual Report on Form 10-K, filed on February 26, 2009)
10.25*	Offer Letter, dated as of November 16, 2012, between Itron, Inc. and Philip C. Mezey. (Filed as Exhibit 10.1 to Itron, Inc.’s Current Report on Form 8-K, filed on November 19, 2012)
10.26	Cooperation Agreement by and among Itron, Inc., Coppersmith Capital Management LLC, Scopia Management, Inc. and certain of their specified affiliates, Jerome J. Lande and Peter Mainz, dated as of December 9, 2015. (Filed as Exhibit 10.1 to Itron, Inc.'s Current Report on Form 8-K, filed on December 11, 2015)
10.27	Amendment to Cooperation Agreement by and among Itron, Inc., Coppersmith Capital Management LLC, Scopia Management, Inc. and certain of their specified affiliates, Jerome J. Lande and Peter Mainz. (Filed as Exhibit 10.2 to Itron, Inc.’s Quarterly Report on Form 10-Q, filed on November 3, 2016)
10.28	First Amendment to Cooperation Agreement, dated November 1, 2017, by and among Itron, Inc., Scopia Management, Inc. and certain of their specified affiliates, Jerome J. Lande and certain other individuals. (Filed as Exhibit 10.1 to Itron, Inc.'s Current Report on Form 8-K, filed on November 2, 2017)
10.29*	Form of Stock Option Grant Notice and Agreement for use in connection with both incentive and non-qualified stock options granted under Itron, Inc.'s Amended and Restated 2010 Stock Incentive Plan. (Filed as Exhibit 10.1 to Itron, Inc.'s Quarterly Report on Form 10-Q, filed on May 4, 2017)
10.30*	Form of Long-Term Performance RSU Award Notice and Agreement for U.S. Participants for use in connection with Itron, Inc.'s Amended and Restated 2010 Stock Incentive Plan. (Filed as Exhibit 10.2 to Itron, Inc.'s Quarterly Report on Form 10-Q, filed on May 4, 2017)
10.31*	Form of RSU Award Notice and Agreement for all Participants for use in connection with Itron, Inc.'s Amended and Restated 2010 Stock Incentive Plan. (Filed as Exhibit 10.3 to Itron, Inc.'s Quarterly Report on Form 10-Q, filed on May 4, 2017)
10.32*	Form of Stock Option Grant Notice and Agreement for use in connection with both incentive and non-qualified stock options granted under Itron, Inc.'s Amended and Restated 2010 Stock Incentive Plan. (filed with this report)

10.33*	Form of Long-Term Performance RSU Award Notice and Agreement for U.S. Participants for use in connection with Itron, Inc.'s Amended and Restated 2010 Stock Incentive Plan. (filed with this report)
10.34*	Form of RSU Award Notice for awards with 1 year vesting and Agreement for all Participants for use in connection with Itron, Inc.'s Amended and Restated 2010 Stock Incentive Plan. (filed with this report)
10.35*	Form of RSU Award Notice for awards with 2 year vesting and Agreement for all Participants for use in connection with Itron, Inc.'s Amended and Restated 2010 Stock Incentive Plan. (filed with this report)
10.36*	Form of RSU Award Notice for awards with 3 year vesting and Agreement for all Participants for use in connection with Itron, Inc.'s Amended and Restated 2010 Stock Incentive Plan. (filed with this report)

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Exhibit Number	Description of Exhibits
21.1	Subsidiaries of Itron, Inc. (filed with this report)
23.1	Consent of Deloitte & Touche LLP Independent Registered Public Accounting Firm. (filed with this report)
31.1	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. (filed with this report)
31.2	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. (filed with this report)
32.1	Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (furnished with this report)
101.SCH	XBRL Taxonomy Extension Schema. (submitted electronically with this report in accordance with the provisions of Regulation S-T)
101.CAL	XBRL Taxonomy Extension Calculation Linkbase. (submitted electronically with this report in accordance with the provisions of Regulation S-T)
101.DEF	XBRL Taxonomy Extension Definition Linkbase. (submitted electronically with this report in accordance with the provisions of Regulation S-T)
101.LAB	XBRL Taxonomy Extension Label Linkbase. (submitted electronically with this report in accordance with the provisions of Regulation S-T)
101.PRE	XBRL Taxonomy Extension Presentation Linkbase. (submitted electronically with this report in accordance with the provisions of Regulation S-T)
*	Management contract or compensatory plan or arrangement.

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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 Liberty Lake, State of Washington, on the 28th day of February, 2019.

ITRON, INC.

By: /s/ JOAN S. HOOPER

Joan S. Hooper

Senior Vice President and Chief Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated on the 28th day of February, 2019.

Signatures	**Title**
/s/ PHILIP C. MEZEY	
Philip C. Mezey	President and Chief Executive Officer (Principal Executive Officer), Director
/s/ JOAN S. HOOPER	
Joan S. Hooper	Senior Vice President and Chief Financial Officer
/s/ THOMAS S. GLANVILLE	
Thomas S. Glanville	Director
/s/ FRANK M. JAEHNERT	
Frank M. Jaehnert	Director
/s/ JEROME J. LANDE	
Jerome J. Lande	Director
/s/ TIMOTHY M. LEYDEN	
Timothy M. Leyden	Director
/s/ DANIEL S. PELINO	
Daniel S. Pelino	Director
/s/ GARY E. PRUITT	
Gary E. Pruitt	Director
/s/ DIANA D. TREMBLAY	
Diana D. Tremblay	Director
/s/ LYNDA L. ZIEGLER	
Lynda L. Ziegler	Chair of the Board