Armour Residential REIT, Inc.
Form 10-Q
August 01, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended June 30, 2012

OR

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

For the transition period from to

ARMOUR RESIDENTIAL REIT, INC.
(Exact name of registrant as specified in its charter)

Maryland	001-34766	26-1908763
(State or other jurisdiction of incorporation or organization)	(Commission File Number)	(I.R.S. Employer Identification No.)

3001 Ocean Drive, Suite 201, Vero Beach, FL 32963
(Address of principal executive offices)(zip code)

(772) 617-4340
(Registrant’s telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding twelve 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 ý NO o

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 during the preceding twelve months (or for such shorter period that the registrant was required to submit and post such files). YES ý NO ¨

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

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

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

The number of outstanding shares of the Registrant’s common stock as of July 30, 2012 was 234,226,342.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

ARMOUR Residential REIT, Inc. and Subsidiary
CONDENSED CONSOLIDATED BALANCE SHEETS
(dollars in thousands, except share and per share amounts)
(Unaudited)

Assets	June 30, 2012	December 31, 2011
Cash	$ 326,736	$ 252,372
Restricted cash	193,086	147,199
Agency securities, available for sale, at fair value (including pledged assets of $12,758,125 and $5,225,234)	13,328,514	5,393,675
Receivable for unsettled securities	-	382,931
Derivatives, at fair value	9,600	-
Principal payments receivable	9,190	12,493
Accrued interest receivable	38,544	18,637
Prepaid and other assets	823	440
Total Assets	$ 13,906,493	$ 6,207,747
Liabilities and Stockholders' Equity		
Liabilities:		
Repurchase agreements	$ 12,112,586	$ 5,335,962
Payable for unsettled securities	272,863	117,885
Derivatives, at fair value	156,515	121,727
Accrued interest payable	3,373	2,154
Accounts payable and accrued expenses	2,790	2,663
Dividends payable	276	750
Total Liabilities	12,548,403	5,581,141
Stockholders' Equity:		
Preferred stock, $0.001 par value, 25,000,000 shares authorized, 1,400,000 8.250% Series A Cumulative Preferred Stock issued and outstanding at June 30, 2012 and none issued and outstanding at December 31, 2011	1	-
Common stock, $0.001 par value, 500,000,000 shares authorized, 188,185,880 and 95,436,949 shares issued and outstanding at June 30, 2012 and December 31, 2011, respectively	188	95
Additional paid-in capital	1,340,403	678,641
Accumulated deficit	(150,152)	(100,878)
Accumulated other comprehensive income	167,650	48,748
Total Stockholders' Equity	1,358,090	626,606
Total Liabilities and Stockholders' Equity	$ 13,906,493	$ 6,207,747

See notes to condensed consolidated financial statements.

ARMOUR Residential REIT, Inc. and Subsidiary
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(dollars in thousands, except per share amounts)
(Unaudited)

	For the Quarters Ended		For the Six Months Ended	
	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
Interest Income:				
Interest income, net of amortization of premium	$ 86,204	$ 29,105	$ 148,967	$ 42,629
Interest expense:				
Repurchase agreements	(11,106)	(2,351)	(18,036)	(3,707)
Net interest income	75,098	26,754	130,931	38,922
Other (Loss) Income:				
Realized (loss) gain on sale of agency securities	(1,268)	-	5,048	-
Other income	1,043	-	1,043	-
Subtotal	(225)	-	6,091	-
Realized loss on derivatives (1)	(12,400)	(6,078)	(22,140)	(8,004)
Unrealized loss on derivatives	(70,394)	(25,817)	(52,780)	(26,083)
Subtotal	(82,794)	(31,895)	(74,920)	(34,087)
Total other (loss)	(83,019)	(31,895)	(68,829)	(34,087)
Expenses:				
Management fee	4,298	1,495	7,811	2,251
Professional fees	425	242	936	613
Insurance	55	51	104	103
Compensation	498	140	992	272
Other	407	200	672	260
Total expenses	5,683	2,128	10,515	3,499
Net (loss) income before taxes	(13,604)	(7,269)	51,587	1,336
Income tax (expense) benefit	(3)	(3)	29	(12)
Net (Loss) Income	$ (13,607)	$ (7,272)	$ 51,616	$ 1,324
Dividends on preferred stock	(160)	-	(160)	-
Net (Loss) Income (related) available to common stockholders	$ (13,767)	$ (7,272)	$ 51,456	$ 1,324
Net (loss) income (related) available per share to common stockholders:				
Basic	$ (0.08)	$ (0.14)	$ 0.33	$ 0.03
Diluted	$ (0.08)	$ (0.14)	$ 0.32	$ 0.03
Dividends per common share	$ 0.30	$ 0.36	$ 0.62	$ 0.70
Weighted average common shares outstanding:				
Basic	180,773	53,259	157,838	39,903
Diluted	180,773	53,259	158,553	40,062

(1) Interest expense related to our interest rate swap contracts is recorded in realized loss on derivatives on the condensed consolidated statements of operations. For additional information, see Note 8 to the condensed consolidated financial statements.

See notes to condensed consolidated financial statements.

ARMOUR Residential REIT, Inc. and Subsidiary
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(dollars in thousands)
(Unaudited)

	For the Quarters Ended		For the Six Months Ended	
	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
Net (Loss) Income	$ (13,607)	$ (7,272)	$ 51,616	$ 1,324
Other comprehensive income :				
Reclassification adjustment for realized loss (gain) on sale of Agency Securities	1,268	-	(5,048)	-
Net unrealized gain on available for sale securities	112,328	36,787	123,950	36,542
Other comprehensive income	113,596	36,787	118,902	36,542
Comprehensive Income	$ 99,989	$ 29,515	$ 170,518	$ 37,866

See notes to condensed consolidated financial statements.

ARMOUR Residential REIT, Inc. and Subsidiary
CONDENSED CONSOLIDATED STATEMENTS of STOCKHOLDERS' EQUITY
(dollars in thousands)
(Unaudited)

	Preferred Stock			Common Stock						
	Shares	Par Amount	Additional Paid in Capital	Shares	Par Amount	Additional Paid in Capital	Total Additional Paid in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Total
Balance, December 31, 2011	-	$-	-	95,437	$95	$678,641	$ 678,641	$(100,878)	$48,748	$626,606
Preferred dividends declared	-	-	-	-	-	-	-	(160)	-	(160)
Common dividends declared	-	-	-	-	-	-	-	(100,730)	-	(100,730)
Issuance of Preferred stock, net	1,400	1	33,778	-	-	-	33,778	-	-	33,779
Issuance of common stock, net	-	-	-	92,705	92	627,724	627,724	-	-	627,816
Stock based compensation, net of withholding requirements	-	-	-	44	1	260	260	-	-	261
Net income	-	-	-	-	-	-	-	51,616	-	51,616
Other comprehensive income	-	-	-	-	-	-	-	-	118,902	118,902
Balance, June 30, 2012	1,400	$1	$33,778	188,186	$188	$1,306,625	$ 1,340,403	$(150,152)	$167,650	$1,358,090

See notes to condensed consolidated financial statements.

ARMOUR Residential REIT, Inc. and Subsidiary
CONDENSED CONSOLIDATED STATEMENTS of CASH FLOWS
(dollars in thousands)
(Unaudited)

	For the Six Months Ended June 30, 2012	For the Six Months Ended June 30, 2011
Cash Flows From Operating Activities:		
Net income	$ 51,616	$ 1,324
Adjustments to reconcile net income to net cash provided by operating activities:		
Net amortization of premium on Agency Securities	33,737	7,933
Unrealized loss on derivatives	25,188	33,478
Realized gain on sale of Agency Securities	(5,048)	-
Stock based compensation	261	145
Changes in operating assets and liabilities:		
Increase in accrued interest receivable	(19,919)	(12,064)
(Increase) decrease in prepaid income taxes and other assets	(678)	430
Increase in accrued interest payable	1,218	428
Increase in accounts payable and accrued expenses	1,498	993
Net cash provided by operating activities	87,873	32,667
Cash Flows From Investing Activities:		
Purchases of Agency Securities	(8,745,763)	(4,074,907)
Principal repayments of Agency Securities	777,772	183,355
Proceeds from sales of Agency Securities	664,588	-
Decrease in restricted cash	(45,887)	(50,631)
Net cash used in investing activities	(7,349,290)	(3,942,183)
Cash Flows From Financing Activities:		
Issuance of preferred stock, net of expenses	33,779	-
Issuance of common stock, net of expenses	627,813	408,837
Proceeds from repurchase agreements	57,438,695	13,771,873
Principal repayments on repurchase agreements	(50,663,141)	(10,088,322)
Common dividends paid	(101,365)	(29,982)
Net cash provided by financing activities	7,335,781	4,062,406
Net increase in cash	74,364	152,890
Cash - beginning of period	252,372	35,344
Cash - end of period	$ 326,736	$ 188,234
Supplemental Disclosure:		
Cash paid for income taxes (not including tax refunds received)	$ 12	$ 15
Cash paid during the period for interest	$ 46,012	$ 2,970
Non-Cash Investing and Financing Activities:		
Payable for unsettled security purchases	$ 272,863	$ 302,680
Unrealized gain on investment in available for sale securities	$ 123,950	$ 36,542
Amounts receivable for issuance of common stock	$ 3	$ 8,225
Common dividends declared, to be paid in subsequent period	$ 8	$ 9
Preferred dividends declared, to be paid in subsequent period	$ 160	$ -

See notes to condensed consolidated financial statements

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ARMOUR Residential REIT, Inc. and Subsidiary
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1 – Basis of Presentation

The accompanying unaudited financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X promulgated by the Securities and Exchange Commission . Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the quarter and six months ended June 30, 2012 are not necessarily indicative of the results that may be expected for the calendar year ending December 31, 2012. These unaudited financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company's annual report on Form 10-K for the year ended December 31, 2011.

Our financial statements are presented in accordance with GAAP. The condensed consolidated financial statements include the accounts of ARMOUR and its subsidiary, all intercompany accounts and transactions have been eliminated. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates affecting the accompanying financial statements include the valuation of Agency Securities and derivative instruments.

Note 2 - Organization and Nature of Business Operations

Business

References to "we", "us", "our", "ARMOUR" or the "Company" are to ARMOUR Residential REIT, Inc. References to "ARRM" are to ARMOUR Residential Management LLC, a Delaware limited liability company. References to "Enterprise" are to Enterprise Acquisition Corp., which is a wholly-owned subsidiary of ARMOUR.

We are an externally managed Maryland corporation organized in 2008, managed by ARRM. We invest primarily in hybrid adjustable rate, adjustable rate and fixed rate residential mortgage backed securities. These securities are issued or guaranteed by a U.S. Government-sponsored entity ("GSE"), such as the Federal National Mortgage Association (Fannie Mae), Federal Home Loan Mortgage Corporation (Freddie Mac) or guaranteed by the Government National Mortgage Administration (Ginnie Mae) (collectively, "Agency Securities"). From time to time, a portion of our portfolio may be invested in unsecured notes and bonds issued by U.S. Government-chartered entities (collectively, "Agency Debt"), U.S. Treasuries and money market instruments, subject to certain income tests we must satisfy for our qualification as a real estate investment trust ("REIT"). On December 1, 2011, our stockholders approved an amendment to our charter to alter our investment asset class restriction in response to potential changes in Agency Securities to include non-Agency as well as Agency Securities in our investment asset class restriction. While we remain committed to investing in Agency Securities for so long as an adequate supply and pricing exists, we believe it is prudent for us to have the flexibility to invest in non-Agency Securities and respond to changes in GSE policy.

We intend to qualify and have elected to be taxed as a REIT under the Internal Revenue Code ("the Code"). Our qualification as a REIT depends on our ability to meet, on a continuing basis, various complex requirements under the Code relating to, among other things, the sources of our gross income, the composition and values of our assets, our distribution levels and the concentration of ownership of our capital stock. We believe that we are organized in conformity with the requirements for qualification as a REIT under the Code and our manner of operations enables us to meet the requirements for taxation as a REIT for federal income tax purposes.

As a REIT, we will generally not be subject to federal income tax on the REIT taxable income that we currently distribute to our stockholders. If we fail to qualify as a REIT in any taxable year and do not qualify for certain statutory relief provisions, we will be subject to federal income tax at regular corporate rates. Even if we qualify as a REIT for federal income tax purposes, we may still be subject to some federal, state and local taxes on our income.

Note 3 - Summary of Significant Accounting Policies

Reclassification

We reclassified previously presented financial information to conform to the presentation in our condensed consolidated financial statements for the quarter and six months ended June 30, 2012 and for the year ended December 31, 2011. Certain commissions with respect to Eurodollar Futures Contracts (“Futures Contracts”) which were previously included in interest expense have been reclassified into realized gain or loss on those contracts. The unrealized gains and losses on our derivatives previously classified on our condensed consolidated statement of operations as an adjustment to arrive at “net interest income after change in fair value of interest rate contracts” is no longer presented as an adjustment to interest income and has been reclassified into “other income” as part of the unrealized gain or loss on derivatives. This reclassification had no effect on previously reported net income or comprehensive income. This reclassification caused interest income to decrease by $0.4 million and $0.6 million, respectively and interest expense to decrease by $6.1 million and $8.1 million, respectively for the quarter and six months ended June 30, 2011. Realized loss on derivatives increased by the net amount of $5.7 million and $7.5 million, respectively for the quarter and six months ended June 30, 2011.

ARMOUR Residential REIT, Inc. and Subsidiary
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Cash

Cash includes cash on deposit with financial institutions and investments in high quality overnight money market funds, all of which have maturities of three months or less, at time of purchase. We may maintain deposits in federally insured financial institutions in excess of federally insured limits. However, management believes we are not exposed to significant credit risk due to the financial position and creditworthiness of the depository institutions in which those deposits are held.

Restricted Cash

Restricted cash at June 30, 2012 and December 31, 2011 represents approximately $193.1 million and $147.2 million, respectively, held by counterparties as collateral.

Agency Securities, at Fair Value

We invest primarily in Agency Securities. A portion of our portfolio may be invested in Agency Debt, U.S. Treasuries and money market instruments, subject to certain income tests we must satisfy for our qualification as a REIT. As of June 30, 2012, all of our financial instrument investments consist of Agency Securities, Agency Debt, U.S. Treasuries, money market instruments (including reverse repurchase agreements), hedging and other derivative instruments related to the foregoing investments.

We generally intend to hold most of our Agency Securities for long-term periods. We may, from time to time, sell any of our Agency Securities as part of our overall management of our portfolio. Management determines the appropriate classifications of the securities at the time they are acquired and evaluates the appropriateness of such classifications at each balance sheet date. As of June 30, 2012, all of our Agency Securities were classified as available for sale. Agency securities classified as available for sale are reported at their estimated fair values, based on fair values obtained from third-party sources, with unrealized gains and losses excluded from earnings and reported as part of the separate condensed consolidated statements of comprehensive income. Agency securities transactions are recorded on the trade date and are valued using third-party pricing services and dealer quotes.

We evaluate securities for other than temporary impairment at least on a quarterly basis and more frequently when economic or market concerns warrant such evaluation. We determine if we (1) have the intent to sell the Agency Securities, (2) believe it is more likely than not that we will be required to sell the securities before recovery or (3) do not expect to recover the entire amortized cost basis of the Agency Securities. There was no other than temporary impairment for the quarters and six months ended June 30, 2012 and June 30, 2011.

Repurchase Agreements

We finance the acquisition of our Agency Securities through the use of repurchase agreements. Our repurchase agreements are secured by our Agency Securities and bear interest rates that have historically moved in close relationship to the Federal Funds Rate and the London Interbank Offered Rate (“LIBOR”). Under these agreements, we sell securities to a lender and agree to repurchase the same securities in the future for a price that is higher than the original sales price. The difference between the sales price that we receive and the repurchase price that we pay represents interest paid to the lender. A repurchase agreement operates as financing under which we pledge our securities as collateral to secure a loan which is equal in value to a specified percentage of the estimated fair value of the pledged collateral. We retain beneficial ownership of the pledged collateral. At the maturity of a repurchase agreement, we are required to repay the loan and concurrently receive back our pledged collateral from the lender or, with the consent of the lender, we may renew such agreement at the then prevailing interest rate. The repurchase agreements may require us to pledge additional assets to the lender in the event the estimated fair value of the existing pledged collateral declines.

Derivatives

We recognize all derivative instruments as either assets or liabilities at fair value on our condensed consolidated balance sheets. We do not designate our derivative activities as cash flow hedges, which, among other factors, would require us to match the pricing dates of both derivative transactions and repurchase agreements. Operational issues and credit market volatility make such matching impractical for us. Since we have not elected cash flow hedge accounting treatment as allowed by GAAP, our operating results may reflect greater volatility than otherwise would be the case, because gains or losses on derivatives may not be offset by changes in the fair value or cash flows of the transaction within the same accounting period or ever. Consequently, any declines in the fair value of our derivatives result in a charge to earnings. We will continue to designate derivative activities as hedges for tax purposes and any unrealized gains or losses would not affect our distributable net taxable income.

ARMOUR Residential REIT, Inc. and Subsidiary
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Accrued Interest Receivable and Payable

Accrued interest receivable includes interest accrued between payment dates on Agency Securities. Accrued interest payable includes interest payable on our repurchase agreements.

Credit Risk

We have limited our exposure to credit losses on our portfolio of Agency Securities by only purchasing securities issued by Freddie Mac, Fannie Mae or Ginnie Mae. The payment of principal and interest on the Freddie Mac and Fannie Mae Agency Securities are guaranteed by those respective agencies and the payment of principal and interest on the Ginnie Mae Agency Securities are backed by the full faith and credit of the U.S. Government.

In September 2008, both Freddie Mac and Fannie Mae were placed in the conservatorship of the U.S. Government. While it is hoped that the conservatorship will help stabilize Freddie Mac's and Fannie Mae's losses and overall financial position, there can be no assurance that it will succeed or that, if necessary, Freddie Mac or Fannie Mae will be able to satisfy their guarantees of Agency Securities. On August 5, 2011, Standard & Poor’s Corporation downgraded the U.S.’s credit rating from AAA to AA+ and on August 8, 2011, Fannie Mae and Freddie Mac’s credit ratings were downgraded from AAA to AA+. Because Fannie Mae and Freddie Mac are in conservatorship of the U.S. Government, the U.S.'s credit rating downgrade and Fannie Mae and Freddie Mac’s credit rating downgrades will impact the credit risk associated with Agency Securities and, therefore, may decrease the value of the Agency Securities in our portfolio.

Market Risk

Weakness in the mortgage market may adversely affect the performance and market value of our investments. This could negatively impact our net book value. Furthermore, if our lenders are unwilling or unable to provide additional financing, we could be forced to sell our Agency Securities at an inopportune time when prices are depressed.

Preferred Stock

At June 30, 2012, we were authorized to issue up to 25,000,000 shares of preferred stock, par value $0.001 per share with such designations, voting and other rights and preferences as may be determined from time to time by our Board of Directors (“Board”) or a committee thereof. On June 6, 2012, we filed with the State Department of Assessments and Taxation of the State of Maryland to designate 1,610,000 shares of the 25,000,000 authorized preferred stock as 8.250% Series A Cumulative Preferred Shares (“Series A Preferred Stock”) with the powers, designations, preferences and other rights as set forth therein. At June 30, 2012, we had issued and outstanding 1,400,000 shares of Series A Preferred Stock, with a par value $0.001 per share and a liquidation preference of $25.00 per share plus accrued and unpaid dividends. The Series A Preferred Stock is entitled to a dividend at a rate of 8.250% per year based 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 exclusively at our option commencing on June 7, 2017 (subject to our right under limited circumstances to redeem the Series A Preferred Stock earlier in order to preserve our qualification as a REIT). The Series A Preferred Stock is senior to the our common stock and therefore in the event of liquidation, dissolution or winding up, the Series A Preferred Stock will receive a liquidation preference of $25.00 per share plus accumulated and unpaid dividends before distributions are paid to holders of our common stock, with no right or claim to any of our remaining assets thereafter. The Series A Preferred Stock generally does not have voting rights except if we fail to pay dividends on the Series A Preferred Stock for eighteen months, whether or not consecutive. Under such circumstances, 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 restricted for payment. The Series A Preferred Stock has no stated maturity, is not subject to any sinking fund or mandatory redemption and will remain outstanding indefinitely unless repurchased or redeemed by us or converted into our common stock in connection with a change of control by the holders of Series A Preferred Stock.

Common Stock and Warrants

At June 30, 2012, we were authorized to issue up to 500,000,000 shares of common stock, par value $0.001 per share, with such designations, voting and other rights and preferences as may be determined from time to time by our Board. We had 188,185,880 shares of common stock issued and outstanding at June 30, 2012. At June 30, 2012, we had outstanding warrants to purchase 32,500,000 shares of common stock, which are exercisable at $11.00 per share and expire in 2013.

ARMOUR Residential REIT, Inc. and Subsidiary
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Income per Common Share

The following table presents a reconciliation of the net (loss) income and the shares used in calculating basic and diluted earnings per share for the quarters and six months ended June 30, 2012 and June 30, 2011.

	For the Quarters Ended		For the Six Months Ended	
	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
Net (Loss) Income (related) available to common stockholders	$ (13,767)	$ (7,272)	$ 51,456	$ 1,324
Weighted average common shares outstanding - basic	180,773	53,259	157,838	39,903
Add: Effect of dilutive non-vested restricted stock awards, assumed vested	-	-	715	159
Weighted average common shares outstanding- diluted	180,773	53,259	158,553	40,062

32,500,000 warrants were outstanding and considered anti-dilutive as their exercise price exceeded the average stock price for the quarters and six months ended June 30, 2012 and June 30, 2011.

Comprehensive Income

Comprehensive income refers to change in equity during a period from transactions and other events and circumstances from non-owner sources. It includes all changes in equity during a period except those resulting from investments by owners and distributions to owners.

Revenue Recognition

Interest income is earned and recognized based on the unpaid principal amount of the Agency Securities and their contractual terms. Premiums and discounts associated with the purchase of Agency Securities are amortized or accreted into interest income over the actual lives of the securities using the effective interest method.

Income Taxes

We intend to qualify and have elected to be taxed as a REIT under the Code. We will generally not be subject to federal income tax to the extent that we distribute our taxable income to our stockholders and as long as we satisfy the ongoing REIT requirements under the Code including meeting certain asset, income and stock ownership tests.

Our management is responsible for determining whether a tax position taken by us is more likely than not to be sustained on its merits. We have no material unrecognized tax benefits and have not recognized in these financial statements any interest or penalties related to income taxes. Should any such interest and penalties be recognized, they will be included in interest expense and other expenses, respectively. None of our income tax returns have been examined by federal, state or local authorities; therefore our 2009, 2010 and 2011 federal and state tax returns remain open for examination.

Note 4 - Recent Accounting Pronouncements

Accounting Standards Adopted in 2012

We adopted recent amendments to authoritative guidance issued by the Financial Accounting Standards Board ("FASB") in April 2011 related to the accounting for repurchase agreements and other agreements that entitle and obligate a transferor to repurchase or redeem financial assets before their maturity.

We adopted recent amendments to authoritative guidance issued by FASB in May 2011 to establish common fair value measurement and disclosure requirements in GAAP and International Financial Reporting Standards.

We adopted recent amendments to authoritative guidance issued by FASB in June and December 2011 providing for the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements.

ARMOUR Residential REIT, Inc. and Subsidiary
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Accounting Standards to be Adopted in Future Periods

In December 2011, the FASB issued amendments to authoritative guidance requiring entities that have financial instruments and derivative instruments to disclose information about offsetting and related arrangements. The disclosures required under this amended guidance are intended to enable users of an entity's financial statements to evaluate the effect or potential effect of netting arrangements on an entity's financial position, including the effect or potential effect of rights of offset associated with certain financial instruments and derivative instruments. The provisions of these amendments are effective for annual periods beginning after January 1, 2013. We anticipate the adoption of these amendments may change the presentation of our financial statements and related disclosures.

Note 5 - Agency Securities, Available for Sale

All of our Agency Securities are classified as available for sale and, as such, are reported at their estimated fair value.

As of June 30, 2012, we had the following securities in an unrealized gain or loss position as presented below. The components of the carrying value of our Agency Securities as of June 30, 2012 are also presented below.

June 30, 2012	Fannie Mae	Freddie Mac	Ginnie Mae	Total Agency Securities
		(dollars in thousands)		
Principal Amount	$ 8,253,755	$ 3,963,691	$ 344,154	$ 12,561,600
Net unamortized premium	393,551	189,778	15,935	599,264
Amortized cost	8,647,306	4,153,469		