PATRICK INDUSTRIES INC
Form 10-Q
August 14, 2007
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 June 30, 2007

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 0-3922

PATRICK INDUSTRIES, INC.

(Exact name of Company as specified in its charter)

INDIANA (State or other jurisdiction of incorporation or organization)	35-1057796 (I.R.S. Employer Identification No.)

107 West Franklin Street, Elkhart, IN 46516

(Address of principal executive offices)

(ZIP Code)

(574) 294-7511

(Company s telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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 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] Noo

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. (check one):

Large accelerated filer o Accelerated filer o Non-accelerated filer [X]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.)

Yes o No [X]

As of August 9, 2007, there were 5,984,427 shares of the Company s Common Stock outstanding.

PATRICK INDUSTRIES, INC.

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PART I: FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

See accompanying notes to Unaudited Condensed Financial Statements.

See accompanying notes to Unaudited Condensed Financial Statements

PATRICK INDUSTRIES, INC.

NOTES TO UNAUDITED CONDENSED FINANCIAL STATEMENTS

(dollars in thousands, except shares and per share amounts)

1. General

In the opinion of Patrick Industries, Inc. (the Company), the accompanying unaudited condensed financial statements contain all adjustments (consisting of only normal recurring accruals) necessary to present fairly the Company s financial position as of June 30, 2007, and December 31, 2006, and the results of operations for the three and six months ended June 30, 2007 and 2006, and cash flows for the six months ended June 30, 2007 and 2006.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. For a description of significant accounting policies used by the Company, in the preparation of its consolidated financial statements, please refer to Note 1 of the Notes to the Financial Statements in the Company s Annual Report on Form 10-K for the year ended December 31, 2006. The results of operations for the three and six month periods ended June 30, 2007 and 2006 are not necessarily indicative of the results to be expected for the full year.

Certain reclassifications have been made in the 2006 consolidated financial statements to conform to the presentation used in 2007.

Summary of Accounting Policies

Inventories

The inventories on June 30, 2007 and December 31, 2006 consist of the following classes:

	June 30, 2007	December 31, 2006
Raw materials	$27,286	$28,067
Work in process	3,044	804
Finished goods	8,832	6,330
Total manufactured goods	39,162	35,201
Distribution products	9,322	8,098
Total inventories	$48,484	$43,299

Inventories are stated at the lower of cost (first-in, first-out (FIFO) method) or market.

Goodwill

Goodwill is not amortized. Instead, goodwill will be tested for impairment at least annually. A two-step impairment test is used to identify potential goodwill impairment. The first step of the goodwill impairment test, used to identify potential impairment, compares the fair value of a reporting unit (as defined) with its carrying amount, including goodwill. If the fair value of the reporting unit exceeds its carrying amount, goodwill is not considered impaired, and the second step of the goodwill impairment test is unnecessary. The second step measures the amount of impairment, if any, by comparing the carrying value of the goodwill associated with a reporting unit to the implied fair value of the goodwill derived from the estimated overall fair value of the reporting unit and the individual fair values of the other assets and liabilities of the reporting unit. No impairment was recognized during the quarter or six months ended June 30, 2007.

Debt Issue Costs

The cost of obtaining financing is being amortized using the effective interest method over the terms of the respective obligations/securities.

2. Acquisitions

American Hardwoods, Inc.

On January 29, 2007, the Company acquired certain assets of American Hardwoods, Inc. (American Hardwoods), a Phoenix, Arizona based distributor of wood products to the industrial markets, for $7.1 million. The Company believes that the acquisition of American Hardwoods will strengthen its platform in the industrial market sector, as well as provide diversification opportunities and add new products to its Distribution segment. The purchase of American Hardwoods represents an acquisition of a business and has been accounted for in accordance with SFAS No. 141 *Business Combinations*. The results of operations for American Hardwoods are included in the Company s Distribution segment for the three and five month periods ended June 30, 2007.

The cash consideration exchanged for the assets of American Hardwoods was funded with new debt totaling $7.5 million.

Assets acquired and liabilities assumed in the acquisition were recorded on the Company s Consolidated Balance Sheets based at their estimated fair values as of the date of the acquisition. The excess of the estimated fair values of the underlying assets acquired and liabilities assumed over the purchase price was allocated pro-rata to the long lived assets of American Hardwoods. The purchase price allocation is preliminary and a final determination of required purchase accounting adjustments will be made upon finalization of asset valuations and deferred income tax matters. Revision to the fair values will be recorded by the Company as further adjustments to the purchase price allocation.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed on January 29, 2007:

Current assets	$4,273
Property, plant and equipment	3,445
Total assets acquired	7,718
Current liabilities	(322)
Excess fair value over consideration paid	(260)
Net assets acquired	$7,136

Adorn Holdings, Inc.

On May 18, 2007, the Company consummated its acquisition of all of the outstanding capital stock of Adorn Holdings, Inc., (Adorn) an Elkhart, Indiana based manufacturer and supplier of interior components to the recreational vehicle and manufactured housing industries for $75,000 in cash, subject to an adjustment for working capital at closing. The Company believes the acquisition of Adorn will result in significant benefits to the Company, including increased market penetration into its core manufacturing sectors, improved operating efficiencies based on increased capacity utilization and the implementation of best practices amongst two of the industry s leading suppliers, the addition of strong management team members, and other synergy opportunities including logistics, personnel, product base, and certain strategic purchasing opportunities. The acquisition was financed through both debt and equity financing which was structured to provide additional liquidity to facilitate the combined companies future growth plans and working capital needs. The purchase of Adorn represents an acquisition of a business and has been accounted for in accordance with SFAS No. 141 *Business Combinations.* The results of operations for Adorn are included in the Company s consolidated financial statements and respective operating segments for the six week period ended June 30, 2007.

The following table summarizes the aggregate consideration paid for the acquisition, with reconciliation to the total net assets acquired:

The cash consideration exchanged for the capital stock of Adorn was funded through the issuance of Patrick Industries, Inc. common stock in a private placement to Tontine Capital Partners, LP and Tontine Overseas Master Fund, LP, collectively (Tontine) of $11,025, the issuance of senior subordinated debt to Tontine of approximately $13,975, term debt of $50,000 under the Company s new $110 million credit facility, and borrowings under the Company s revolving line of credit of $3,814. Tontine, a significant shareholder of the Company, increased its ownership percentage in Patrick Industries, Inc. from 26.6% to 38.3% as a result of this transaction.

Assets acquired and liabilities assumed in the acquisition were recorded on the Company s condensed balance sheets based at their estimated fair values as of the date of the acquisition. The purchase price allocation is preliminary and a final determination of required purchase accounting adjustments will be made upon finalization of asset valuations and deferred income tax matters. Revision to the fair values will be recorded by the Company as further adjustments to the purchase price allocation. The following table summarizes the estimated fair values of the assets acquired and liabilities assumed on May 18, 2007 (in thousands):

As part of the purchase price allocation, the Company valued acquired inventory at fair value as of the date of the acquisition. The effect of this valuation adjustment was to increase the acquired inventory by $0.2 million. Based on the average rate at which inventory turns, this adjustment was fully expensed through cost of sales during the quarter ended June 30, 2007.

As of June 30, 2007, the Company had not completed its analysis of the income tax matters and elections related to the Adorn acquisition and, therefore, has not finalized deferred income taxes for temporary differences existing between the basis of assets and liabilities for financial reporting and income tax purposes. Such amounts, if any, will result in an adjustment to goodwill as preliminarily recorded.

In connection with the Adorn acquisition and as part of the purchase price allocation, the Company recorded liabilities of approximately $1.7 million related to involuntary terminations and relocation of certain Adorn employees and related facility closure costs. As integration plans are finalized these liabilities may be increased or decreased with the offset recorded in goodwill.

The following unaudited pro forma information assumes the Adorn and American Hardwoods acquisitions occurred as of January 1st of each of the periods presented. The pro forma information contains the actual combined operating results of Adorn and Patrick with the results prior to the acquisition date, adjusted to reflect the pro forma impact of the acquisition occurring at the beginning of the period. Pro forma adjustments include the amortization of acquired intangible assets and the interest expense on debt incurred to finance the transaction. The pro forma results are not necessarily indicative of what actually would have occurred had the acquisition been in effect for the periods presented (in thousands, except per share data):

3. Restructuring and Integration

During the six weeks ended June 30, 2007, the Company initiated restructuring actions relating to the integration of Adorn. The Company s plan to integrate the two businesses includes closure of duplicate facilities, elimination of redundant jobs, and consolidation of product lines. The restructuring plan includes estimated Adorn and Patrick workforce reductions of approximately 300 employees, 6 of which have been completed as of June 30, 2007, facility closures, and various asset write-downs. Asset write-downs include machinery and equipment, inventory, tooling, and other write-downs directly related to discontinued product lines.

The Company has recorded and accrued restructuring charges of approximately $1.1 million in its statements of operations at June 30, 2007 related to the closing and consolidation of Patrick facilities in conjunction with these consolidation plans. This plan includes estimated Patrick workforce reductions of approximately 150 people, of which 6 have been completed as of June 30, 2007, facility closures, various asset write-downs, and other costs.

The following table summarizes the expected, incurred and remaining costs for the 2007 restructuring plans (in thousands):

The majority of the remaining restructuring activities are expected to be completed during 2007; however, certain of the associated payments will extend beyond 2007. Additional restructuring expenses may be necessary as the integration progresses.

4. Accounting for Uncertainty in Income Taxes

The Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes , on January 1, 2007 ("FIN 48). The implementation of FIN 48 did not have a significant impact on the Company s financial position or results of operations.

As of the beginning of fiscal year 2007, the Company had no unrecognized tax benefits. There has been no significant change in the unrecognized tax benefits during the second quarter ending June 30, 2007.

The Company recognizes interest and penalties related to unrecognized tax benefits through the provision for income taxes.

The Company is subject to periodic audits by domestic and foreign tax authorities. Currently, the Company is undergoing routine periodic audits in domestic tax jurisdictions. It is reasonably possible that the amounts of unrecognized tax benefits could change in the next 12 months as a result of the audits. Based on the current audits in process, the payment of taxes as a result of audit settlements are not expected to be significant.

For the majority of tax jurisdictions, the Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 2003.

5. Stock Based Compensation

The Company accounts for stock-based compensation in accordance with the fair value recognition provisions of SFAS No. 123(R) "Share Based Payment". The Company recognized compensation cost of $440 and $211 and related income tax benefits of $175 and $84 for its stock-based compensation plans in the statement of operations for the six months ended June 30, 2007, and 2006, respectively.

The Company estimates the fair value of all stock option awards and stock grants as of the grant date by applying the Black-Scholes option pricing model. The board of directors approved the granting of approximately 60,000 shares on June 1, 2007. The compensation cost associated with this grant has been appropriately recognized in the consolidated financial statements at June 30, 2007.

As of June 30, 2007, there was approximately $1,093 of total unrecognized compensation cost related to share-based compensation arrangements granted under incentive plans. That cost is expected to be recognized over a weighted-average period of three years.

6. Earnings Per Share

Basic earnings per share is based on the weighted average number of shares outstanding during the period. Diluted earnings per common share is based on the weighted average number of shares outstanding during the period, after consideration of the dilutive effect of stock options and awards. Basic and diluted earnings per share for the three-month and six-month periods ended June 30, were calculated using the average shares as follows:

As the Company reported a net loss for the quarter and six-month period ended June 30, 2007, the dilutive effect of stock options and awards did not enter into the computation of diluted earnings per share because their inclusion would have been anti-dilutive.

7. Comprehensive Income

The changes in the components of comprehensive income (loss) for the three and six month periods ending June 30 are as follows:

As of June 30, 2007 and 2006, the accumulated other comprehensive income (loss), net of tax, relating to unrealized gains and losses on cash flow hedges and changes in accumulated pension benefit was $146 and ($130), respectively.

8. New Accounting Standards

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In June 2007, the FASB ratified the consensus on Emerging Issues Task Force (EITF) Issue No. 06-11, *Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards* (EITF 06-11). EITF 06-11 requires companies to recognize the income tax benefit realized from dividends or dividend equivalents that are charged to retained earnings and paid to employees for non-vested equity-classified employee share-based payment awards as an increase to additional paid-in capital. EITF 06-11 is effective for fiscal years beginning after September 15, 2007 (fiscal year 2008 for the Company). While the Company is currently evaluating the provisions of EITF 06-11, the adoption is not expected to have a material impact on its consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS No. 159"). This statement provides a fair value option election that allows companies to irrevocably elect fair value as the initial and subsequent measurement attribute for certain financial assets and liabilities, with changes in fair value recognized in earnings as they occur. SFAS No. 159 permits the fair value option election on an instrument by instrument basis at initial recognition of an asset or liability or upon an event that gives rise to a new basis of accounting for that instrument. SFAS No. 159 is effective as of the beginning of an entity's first fiscal year that begins on or after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007 provided that the entity makes that choice in the first 120 days of that fiscal year, has not yet issued financial statements for any interim period of the fiscal year of adoption, and also elects to early adopt the provisions of SFAS No. 157, Fair Value Measurements . The Company has not determined if it will make the optional election to adopt the provisions of SFAS No. 159, and is currently evaluating its impact.

9. Resignation of an Officer

On March 13, 2007, the Company announced the resignation of its Executive Vice President of Operations. In conjunction with this resignation the Company entered into a separation agreement, including severance payments and retirement benefits. The Company has recognized approximately $450 of severance and retirement benefits in its statement of operations for the six months ended June 30, 2007. In addition, the Company has recorded accrued liabilities of approximately $400 relating to this obligation at June 30, 2007.

10. Segment Information

The Company has determined that its reportable segments are those that are based on the Company s method of internal reporting, which segregates its business by product category and production/distribution process. The Company s reportable segments are as follows:

Primary Manufactured Products - Utilizes various materials, including gypsum, particleboard, plywood, and fiberboard, which are bonded by adhesives or a heating process to a number of products, including vinyl, paper, foil, and high pressure laminate. These products are utilized to produce furniture, shelving, wall, counter, and cabinet products with a wide variety of finishes and textures.

Distribution - Distributes pre-finished wall and ceiling panels, drywall finishing products, particleboard, hardboard and vinyl siding, roofing products, high pressure laminates, passage doors, various flooring products, building hardware, insulation, and other products.

Other Component Manufactured Products - Includes an adhesive division, two cabinet door divisions, a vinyl printing division, and a machine manufacturing division. The Company closed its machine manufacturing division in the fourth quarter of 2006.

Engineered Solutions Includes aluminum extrusion, distribution, and fabrication.

The table below presents unaudited information about the revenue, gross profit, operating income, and total assets of those segments: (dollars in thousands)

Reconciliation of segment operating income to consolidated operating income (dollars in thousands):

Reconciliation of segment assets to consolidated assets (dollars in thousands):

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

GENERAL

The first and second quarters of 2007 for Patrick Industries (the Company) could be characterized as a time of transformation for the Company. In January, the Company completed the acquisition of American Hardwoods, an industrial distribution company located in Phoenix, Arizona, representing our first acquisition since 1998. In May, we completed the acquisition of Adorn Holdings, Inc, a manufacturer and supplier to the Manufactured Housing, Recreational Vehicle, and Industrial markets. Both acquisitions fit within the framework of the Company s strategic plan as it relates to strong historical financial performance, solid management teams, positive profit analysis and projections, and competitive pricing multiples, among others.

The recently completed Adorn acquisition presents numerous synergistic opportunities, including facility rationalization, headcount reduction, increased capacity utilization, increased purchasing leverage and presence, and the combination of two strong management teams working together to facilitate best practices among industry leaders. From a demographic and logistics perspective, Adorn in its original form, operated out of 10 business units located in 8 different states. The Patrick platform was comprised of 27 different business units (including distribution) located in 12 different states. Together, the combined company facilities overlap in 6 of the 8 states in which Adorn is located. The combined management teams are diligently working to capitalize on the synergy opportunities, with completion of a majority of the initiatives by the fourth quarter of 2007, and the final completion of the integration by the second quarter of 2008. To date, the Company has closed and consolidated two Adorn operations into Patrick facilities, closed operations at the Company s unprofitable hardwood cabinet door division in Oregon and transferred that business to Adorn s state-of-the-art cabinet door operation in Elkhart, Indiana, reduced overall headcount by approximately 145 people, and reallocated business between locations to improve efficiencies. The Company was further able to capitalize in the second quarter on combined purchasing initiatives to facilitate certain vendor programs, resulting in increased cash flow and the paydown of approximately $9.4 million in senior term debt.

The $75 million acquisition price was funded through both debt and equity financing. The debt financing was provided in the form of a $110 million credit facility comprised of a $75 million term loan and a $35 million revolver. The credit facility was provided by an eight bank syndication led by JPMorgan Securities, Inc. and JPMorgan Chase Bank, N.A. The facility is structured to provide additional liquidity to facilitate the combined companies future growth plans and working capital needs. Additional financing for the acquisition was provided by Tontine Capital Partners, L.P. and its affiliates (Tontine). Tontine, a significant shareholder of Patrick, purchased 980,000 shares of Patrick common stock in a private placement at a purchase price of $11.25, or $11 million in the aggregate. Tontine also provided interim debt financing in the form of senior subordinated notes totaling approximately $14 million. The Company intends to conduct a Rights Offering at $11.25 per share to its common shareholders in the third quarter, the proceeds of which will be used primarily to pay off the senior subordinated notes.

The Adorn opening balance sheet added approximately $32.3 million in current assets, $12.5 million in net property and equipment, $29.8 million in goodwill, and approximately $39.5 million in identifiable intangible assets. On the liability side, the Company recorded approximately $18.5 million in current liabilities and $16.8 million in deferred income taxes. Net working capital at June 30, 2007 increased by approximately $13.8 million as a result of the acquisition. For the six week period ended June 30, 2007, the incremental Adorn sales added approximately $27.8 million to the combined companies revenue base and approximately $1.0 million to the Company s operating income.

The Company s operations for the first and second quarters of 2007 were negatively affected by unfavorable market conditions and overall softness in the major markets that the Company serves. The manufactured housing and recreational vehicle industries, which represent approximately 67% of the Company s sales through the second quarter, experienced their thirteenth and eleventh months of consecutive declines in unit shipments, respectively. The Industrial market was negatively impacted by a decline in the residential housing market. While the Company is still in the process of executing the synergistic facility rationalization initiatives to improve operating efficiencies in its plants through increased capacity utilization, these soft market conditions are expected to continue to have a negative impact on operations.

Sales for the second quarter ended June 30, 2007 increased approximately $18.4 million, or 19.5%, compared to the prior year. The second quarter revenues include approximately $27.8 million from the Adorn operations. Operating income decreased approximately $3.1 million to a loss of $0.6 million in the quarter. Included in the operating results in the second quarter of 2007 are restructuring charges of approximately $1.1 million related to the closing and consolidation of various Patrick facilities as a result of the Adorn acquisition, charges of approximately $0.8 million related to vesting of certain employee benefit obligations, and charges of approximately $0.4 million related to certain litigation settlement costs. Additionally, the quarterly results include operating losses in the company s Patrick hardwood cabinet door division of approximately $0.3 million, which was recently closed and consolidated into Adorn s profitable facility. The Company reported a net loss of $1.3 million for the second quarter of 2007, or $0.24 per share. This compares with net income of $1.3 million, or $0.27 per share, for the second quarter of 2006.

Year to date sales increased approximately $7.3 million, or 4.0%, including the incremental $27.8 million of Adorn sales post-closing of the transaction. Operating income through June 2007 declined to a loss of approximately $1.1 million from income of $4.1 million in the same period in 2006. Year to date operating losses are inclusive of the restructuring and other charges noted above. Year to date net losses through June 2007 were $1.9 million, or $0.38 per share. This compares to income of $2.0 million, or $0.41 per share in 2006.

Inventory levels increased approximately $5.1 million and trade receivables increased approximately $17.8 million over the December 2006 levels due primarily normal cyclical operating cycles and to the acquisition of Adorn and American Hardwoods in the first six months of 2007. These two acquisitions contributed an incremental $16.0 million to inventory and approximately $12.0 million to receivable balances at June 30, 2007. The Company entered into a vendor managed inventory agreement with one of its suppliers in the second quarter resulting in approximately $9.4 million of operating cash flow and reduction of overall inventory balance as it relates to a certain commodity. Raw material product prices continue to face pricing pressures as a result of the soft industry conditions and excess capacity. The majority of price increases over the past 18 months began in the first quarter of 2006 and on average continued through the third quarter of 2006. Economic conditions in the primary industries then began to soften resulting in downward pricing pressure beginning in the fourth quarter of 2006 and

continuing through the second quarter of 2007. Corporate incentive agreements with its suppliers remained constant for the quarter even though net sales were lower. The Company expects overall corporate incentive agreements for the year to begin to trend downward consistent with the current and anticipated market conditions. The Company expects the soft market conditions and excess of supply to result in pricing erosion to continue in the third quarter and carry though the balance of the 2007 year in its major commodity product categories.

The manufactured housing industry, which represents 37% of the Company s sales for the six-month period ending June 30, 2007, experienced shipment decreases of approximately 28% from the same period in 2006. Shipment levels in this industry, exclusive of FEMA units, continue to operate at more than 40 year lows and are projected to be between approximately 95,000 and 105,000 units for the 2007 year, which represents a decline of between 11% and 19% from the 2006 levels. While this industry is still plagued by financing concerns, including lack of funding sources, the Company remains optimistic that permanent rebuilding in the New Orleans and gulf coast area, rising interest rates, mild inflation, and improved job growth may favorably impact this industry going forward. As certain housing manufacturers continue their penetration into the modular housing sector, the demand for the Company s manufactured custom panels continues to shift to the Company s distribution products which include, but are not limited to, the raw substrates and tape and texture products.

The recreational vehicle industry, which represents approximately 30% of the Company s sales for the six-month period ending June 30, 2007, began to show signs of softening in the third quarter of 2006 continuing through the first half of 2007 with shipments down approximately 13% year over year. While conditions have deteriorated slightly, expectations for this industry remain optimistic as demographics point to steady shipment levels for the remainder of the year.

The Company s diversification efforts into the industrial and other markets, which represent approximately 33%, and 26% of the Company s sales for the six months ending June 30, 2007 and 2006, respectively, resulted in additional market penetration. The Company continues to experience customer attrition in this market sector of as a result of continued offshore penetration, a declining residential housing market and consumer electronics market as it relates to the Company s products, and other conditions beyond the Company s control. New sources of demand are developing in the industrial sectors, however, not quickly enough to offset the losses of these large clients. The Company s efforts to penetrate and gain market share in these industries continues because the Company believes certain of its core competencies, including quality customer service, short order lead times, and high volume quality manufacturing, are a strategic fit for the requirements of this customer base.

With the recent strategic acquisitions of American Hardwoods and Adorn, the Company believes that it continues to establish its platform for future growth and create shareholder value, and is positioned to increase revenues in all of the markets that it serves. While market conditions are expected to remain depressed for the remainder of 2007, key focus areas include capturing market share, implementation of lean manufacturing in all manufacturing operations, maintaining a lean organizational structure, controlling costs, and growing all areas of the business. In conjunction with its strategic plan, the Company has invested significantly in capital over the past three years to increase efficiencies and automation, add capacity and value added capabilities, and appropriately maintain its facilities and equipment. The capital plan for 2007 includes expenditures up to $6 million, including $2.5 million in carryover expenditures from 2006 related to the addition of the new paint line equipment and facility in the Company s Engineered Solutions segment.

The following table sets forth the percentage relationship to net sales of certain items in the Company s Statements of Operations:

RESULTS OF OPERATIONS

Quarter Ended June 30, 2007 Compared to Quarter Ended June 30, 2006

Net Sales. Net sales increased $18.4 million, or 19.5%, to $113.1 million in the second quarter of 2007 from $94.7 million in the second quarter of 2006 primarily as a result of the Adorn acquisition in May 2007. The 2007 second quarter includes approximately six weeks of activity from Adorn, or approximately $27.8 million, and the incremental sales from American Hardwoods, which was acquired in January 2007, of approximately $3.7 million. Exclusive of the incremental sales volume from these two acquisitions, net sales decreased primarily due to continued weakness in all three of the primary markets the Company serves. The manufactured housing industry, which comprises approximately 37% of the Company s revenue base, experienced shipment declines for thirteen consecutive months through June 2007 and a quarter over quarter decline of approximately 18%. Shipments in the recreational vehicle industry, which represents approximately 30% of the Company s consolidated revenue base, decreased by more than 10% when compared to the same three month period in 2006. The industrial market, which represents 33% of the Company s revenue base, began feeling the impact of the slowing housing activity from prior quarters as approximately 85% of our industrial business segments are linked to housing. As a result we began to see deterioration in demand from our largest markets which include kitchen cabinets and furniture.

Restructuring charges. During the six-week period ended June 30, 2007, the Company initiated restructuring actions relating to the closing and consolidation of Patrick operating units associated with the continued integration of the Adorn acquisition. The Company s plan to close and consolidate several business units includes the closure of duplicate facilities, elimination of redundant jobs, consolidation of product lines, and improved capacity utilization. The restructuring plan at June 30, 2007 includes estimated Patrick workforce reductions of approximately 150 employees, approximately 6 of which had been completed as of June 30, 2007, facility closures, and various asset write-downs. Asset write-downs include inventory, tooling, machinery and equipment due to duplication, and shut down of certain product lines. Total restructuring charges related to this plan are expected to be approximately $1.1 million. Of these restructuring charges, $0.9 million were included in a separate line item in cost of sales, while selling and administrative restructuring charges of approximately $0.2 million were reported in a separate line item in operating expenses on the statement of operations. The majority of the restructuring activities are expected to be completed during 2007, with the balance to be completed by the second quarter of 2008. Additional restructuring charges may be necessary as the integration progresses.

Gross Profit. Gross profit increased $0.3 million, or 2.4%, to $12.0 million in the second quarter of 2007 from $11.7 million in the second quarter of 2006. The increase is attributable to the approximate $3.7 million in incremental contribution from the Adorn and American Hardwoods acquisitions. Gross profit increases were offset by the effect of approximately $0.9 million in Patrick restructuring charges related to the Adorn acquisition and the closing and consolidation of several operating units and related severance and benefit packages for workforce reduction as a result of these initiatives. Additionally, gross profit was negatively affected by the purchase accounting adjustment of approximately $0.2 million related to the write-up of inventory to fair market value at the closing date. Exclusive of the incremental Adorn contribution and the restructuring charges gross profit decreased primarily as a result of decreased sales volume from period to period.

Warehouse and Delivery Expenses. Warehouse and delivery expenses increased $1.3 million, or 32.7%, to $5.2 million in the second quarter of 2007 from $3.9 million in the second quarter of 2006. As a percent of net sales, warehouse and delivery expenses increased approximately 0.5% to 4.6% in 2007 from 4.1% in 2006. The increase in dollars is primarily attributable to the increased expense from the Adorn acquisition which impacted percent of net sales by approximately 0.7%.

Selling, General, and Administrative Expenses. Selling, general, and administrative expenses increased by $2.1 million, or 40.3%, to $7.4 million in the second quarter of 2007 from $5.3 million in the second quarter of 2006. As a percent of net sales, selling, general, and administrative expenses increased 0.9%, to 6.5% in 2007 from 5.6% in 2006. Selling, general, and administrative expenses include charges in the second quarter of 2007 of approximately $0.8 million related to certain vesting of employee retirement obligations in conjunction with the Adorn transaction and related financing activities, and approximately $0.2 million in restructuring charges for severance packages and other contractual closing costs to be incurred in conjunction with various consolidation activities related to the acquisition integration plans. Additionally, the incremental expenses from Adorn and American Hardwoods added approximately $1.5 million to expense in the second quarter of 2007.

Operating Income. Operating income decreased by $3.1 million to a loss of $0.6 million in the second quarter of 2007 from income of $2.5 million in the second quarter of 2006. The decrease is primarily attributable to the factors described above.

Interest Expense, Net. Interest expense, net increased $1.2 million to $1.5 million in the second quarter of 2007 from $0.3 million in the same period in 2006. The increase is due to increased debt levels attributable to the recently completed

credit agreement in conjunction with the acquisition of Adorn and American Hardwoods. The Company entered into an agreement led by JPMorgan Securities, Inc. and JPMorgan Chase Bank, N.A., in an eight bank syndication, for a credit facility totaling $110 million. The facility includes a $75 million term loan and a $35 million revolving line of credit. The Company s debt service increased from period to period as total debt levels increased approximately $60.5 million from December 2006, and $66.7 million from the second quarter of 2006.

Net income (loss). Net income decreased $2.6 million to a loss of $1.3 million in the second quarter of 2007 from income of $1.3 million in the same period in 2006 due primarily to the factors described above.

Six Months Ended June 30, 2007 Compared to Six Months Ended June 30, 2006

Net Sales. Net sales increased $7.3 million, or 4.0%, to $191.3 million in the six months ended June 30, 2007 from $184.0 million in the same period in 2006. The acquisitions of Adorn and American Hardwoods contributed approximately $34.3 million to net sales for the six months ended June 30, 2007. Exclusive of the sales volume contributions from acquisitions, net sales decreased as a result of continued weakness in the primary markets the Company serves. The manufactured housing industry, which represents approximately 37% of the Company s sales, experienced shipment declines through June 2007 of approximately 28% compared to 2006. The recreational vehicle industry, which represents approximately 30% of the Company s sales volume, experienced shipment declines of approximately 13%, and the industrial and other markets continue to experience weakness following the slowing housing markets. Approximately 85% of the Company s sales are to business segments linked to housing. The Company estimates approximately $30.0 million in volume declines related to major product sales is a result of the weakness in the industries the Company serves.

Restructuring charges. During the six week period ended June 30, 2007, the Company initiated restructuring actions relating to the closing and consolidation of Patrick operating units associated with the continued integration of the Adorn acquisition. The Company s plan to close and consolidate several business units includes the closure of duplicate facilities, elimination of redundant jobs, consolidation of product lines, and improved capacity utilization. The restructuring plan at June 30, 2007 includes estimated Patrick workforce reductions of approximately 150 employees, approximately 6 of which had been completed as of June 30, 2007, facility closures, and various asset write-downs. Asset write-downs include inventory, tooling, machinery and equipment due to duplication and shut down of certain product lines. Total restructuring charges related to this plan are expected to be approximately $1.1 million. Of these restructuring charges, $0.9 million were included in a separate line item in cost of sales, while selling and administrative restructuring charges of approximately $0.2 million were recorded in a separate line item in operating expenses on the statement of operations. The majority of the restructuring activities are expected to be completed during 2007, with all efforts completed by the second quarter of 2008. Additional restructuring charges may be necessary as the integration progresses.

Gross Profit. Gross profit decreased $1.9 million, or 8.4%, to $20.8 million in 2007 from $22.7 million in 2006. Included in gross profit is approximately $4.1 million in incremental contribution from the Adorn and American Hardwoods acquisitions. Also included in gross profit is approximately $0.2 million of charges related to the purchase accounting adjustments for the write-up of inventory at the closing date to fair market value, $0.3 million in charges related to the settlement of certain litigation expenses, and $0.9 million in restructuring charges related to the Adorn acquisition and the closing and consolidation of several operating units and related severance and benefit packages for workforce reduction as a result of these initiatives. Exclusive of the incremental Adorn contribution and the restructuring charges gross profit decreased primarily as a result of decreased sales volume from period to period.

Warehouse and delivery expenses. Warehouse and delivery expenses increased $1.0 million, or 12.9%, to $8.9 million in 2007 from $7.9 million in 2006. As a percent of net sales, warehouse and delivery expenses increased 0.4% to 4.7% in 2007 from 4.3% in 2006. The increase is attributable to increased expenses from the Adorn acquisition which impacted warehouse and delivery expenses by 0.5%.

Selling, general, and administrative expenses. Selling, general, and administrative expenses increased by $2.3 million, or 21.2%, to $13.0 million in the six-month period ending June 30, 2007 from $10.7 million in the same period in 2006. As a percent of net sales, selling, general, and administrative expenses increased 0.9% to 6.7% in 2007 from 5.8% in 2006. Selling, general, and administrative expenses include charges through June 2007 of approximately $1.1 million related to certain vesting of employee retirement obligations in conjunction with the Adorn transaction and related financing activities, and approximately $0.2 million in restructuring and other charges for severance packages and other contractual closing costs incurred and to be incurred in conjunction with various consolidation activities related to the acquisition integration plans.

Additionally, the incremental expenses from Adorn and American Hardwoods added approximately $1.7 million to expense in the second quarter of 2007.

Operating Income. Operating losses were $1.1 million in the six-month period ending June 30, 2007, This compares to income of $4.0 million in the same period in 2006. The decrease is primarily attributable to the factors described above.

Interest Expense, Net. Interest expense, net increased $1.4 million to $2.1 million in the six months ended June 30, 2007 from $0.7 million in the same period in 2006. The increase is due to increased debt levels attributable to the recently completed credit agreement in conjunction with the acquisition of Adorn and American Hardwoods. The Company entered into an agreement led by JPMorgan Securities, Inc. and JPMorgan Chase Bank, N.A. in an eight bank syndication for a credit facility totaling $110 million. The facility includes a $75 million term loan and a $35 million revolving line of credit. The Company s debt service increased from period to period as debt levels increased approximately $60.5 million from December 2006, and $66.7 million from the second quarter of 2006.

Net income (loss). Net income decreased $3.9 million to a loss of $1.9 million in the six months ended June 30, 2007 from income of $2.0 million in the same period in 2006 due primarily to the factors described above.

BUSINESS SEGMENTS

Quarter Ended June 30, 2007 Compared to Quarter Ended June 30, 2006

PRIMARY MANUFACTURED PRODUCTS SEGMENT DISCUSSION

Net sales. Net sales increased $14.2 million, or 29.6%, to $62.3 million in the second quarter of 2007 from $48.1 million in the second quarter of 2006. The acquisition of Adorn, which primarily included manufacturing operations in this segment, contributed approximately $22.3 million to second quarter 2007 sales. Exclusive of the Adorn contribution, net sales decreased due to continued softness in the primary market sectors this segment serves. The manufactured housing industry experienced declines of 18% for the quarter, the recreational vehicle industry experienced shipment declines of approximately 10%, and the Industrial sector experienced softness as a result of a slowing housing market. The Company estimates that unit volume declines accounted for approximately $6.0 million of sales in the major products the Company supplies in this segment.

Gross profit. Gross profit increased $0.9 million, or 16.8%, to $6.3 million in the second quarter of 2007 from $5.4 million in the same period in 2006. As a percent of net sales, gross profit decreased 1.1% to 10.1% in 2007 from 11.2% in 2006. Gross profit increased as a result of approximately $2.0 million in increased contribution from the Adorn acquisition. Decreased sales volumes in primary products in this segment were partially offset by increased average margins on these products from period to period.

Operating income. Operating income decreased $0.5 million, or 16.2%, to $2.2 million in the second quarter of 2007 from $2.7 million in the second quarter of 2006. As a percent of net sales, operating income decreased 1.9% to 3.6% in 2007 from 5.5% in 2006. The Adorn acquisition contributed approximately $0.9 million to operating income in the second quarter of 2007. The decrease in operating income is a result of decreased sales volume.

DISTRIBUTION SEGMENT DISCUSSION

Net sales. Net sales decreased $2.5 million, or 7.7%, to $29.5 million in the second quarter of 2007 from $32.0 million in the second quarter of 2006. Included in net sales is approximately $3.7 million in increased revenues from the American Hardwoods acquisition in January 2007. The decreased sales volume is due to shipment declines of approximately 10% in the Manufactured Housing industry, which is the primary market sector this segment serves. Unit sales volumes declined approximately 21% on the major commodity product in this segment from quarter to quarter and estimated pricing declines on certain commodity products were approximately 12% from quarter to quarter.

Gross profit. Gross profit decreased $0.2 million, or 4.7%, to $3.8 million in the second quarter of 2007 from $4.0 million in the same period in 2006. As a percentage of net sales, gross profit increased approximately 0.4% to 12.9% in 2007 from 12.5% in 2006. The decrease in dollars is attributable to reduced sales volumes and the increase in gross profit as a percent of net sales is due to price increases on certain commodity products in this segment, increased contribution from new products sales from period to period, and margin maintenance from period to period.

Operating income. Operating income decreased $0.5 million, or 26.2%, to $1.2 million in 2007 from $1.7 million in 2006. The decrease in operating income is attributable to the decrease in sales volume from period to period while fixed costs remained constant.

OTHER COMPONENT MANUFACTURED PRODUCTS SEGMENT DISCUSSION

Net sales. Net sales increased $3.5 million, or 74.1%, to $8.3 million in the second quarter of 2007 from $4.8 million in the second quarter of 2006. The Adorn acquisition contributed approximately $7.1 million in incremental sales to this segment in the second quarter of 2007. Exclusive of the Adorn acquisition, net sales decreased primarily as a result of weakness in both the manufactured housing and recreational vehicles in the second quarter of 2007. In the second quarter of 2007 in conjunction with the acquisition of Adorn and its cabinet door facility in Elkhart, Indiana, the Company finalized plans to close and consolidate its Patrick hardwood cabinet door operation in Oregon into this division. The Company expects to lose approximately $4.0 million in annualized sales volume as a result of this consolidation due primarily to logistics and contribution levels.

Gross profit. Gross profit increased $0.7 million, or 148.2%, to $1.2 million in the second quarter of 2007 from $0.5 million in the second quarter of 2006. As a percent of net sales, gross profit increased 4.2% to 14.2% in 2007 from 10.0% in 2006. The increased gross profit is a result of the incremental volume and profitability from the Adorn acquisition and its state of the art cabinet door facility and vinyl printing facility in the second quarter of 2007.

Operating income. Operating income increased $0.5 million to $0.6 million in the second quarter of 2007 from $0.1 million in the same period in 2006. As a percent of net sales, operating income increased 5.6% to 7.6% in 2007 from 2.0% in 2006. The increase in operating income is attributable to the additional contribution related to the six weeks of activity from the Adorn operating units. The Company s hardwood cabinet door division incurred operating losses of approximately $0.3 million in the second quarter of 2007. A decision was made to close this unprofitable division in the second quarter of 2007 and consolidate a portion of its business into Adorn s profitable state-of-the-art cabinet door facility in Elkhart, Indiana.

ENGINEERED SOLUTIONS SEGMENT DISCUSSION

Net sales. Net sales increased $2.4 million, or 17.9%, to $15.6 million in the second quarter of 2007 from $13.2 million in the same period of 2006. The increased sales volume is attributable to increased unit sales in this segment of approximately 16%, and increased raw aluminum prices of approximately 3% from the second quarter of 2006 to the second quarter of 2007.

Gross profit. Gross profit decreased approximately $0.3 million, or 24.5%, to $0.9 million in the second quarter of 2007 from $1.2 million in the second quarter of 2006. As a percent of net sales, gross profit decreased 3.2% to 5.7% in 2007 from 8.9% in 2006. The decrease in gross profit from period to period is due to several factors including pricing pressures from customers due to soft industrial, housing, and recreational vehicle market conditions, increased fuel costs, and increased costs associated with the start-up of the Company s new $4.5 million powder coat paint facility. The Company expects soft market conditions in the aluminum extrusion market for the remainder of 2007.

Operating income. Operating income decreased $0.3 million to $0.3 million in the second quarter of 2007 from $0.6 million in the same period in 2006 due to the factors described above.

Six Months Ended June 30, 2007 Compared to Six Months Ended June 30, 2006

PRIMARY MANUFACTURED PRODUCTS SEGMENT DISCUSSION

Net sales. Net sales increased $6.0 million, or 6.4%, to $101.0 million in the six month period ending June 30, 2007 from $95.0 million in the same period in 2006. The acquisition of Adorn, which primarily included manufacturing operations in this segment, contributed approximately $22.3 million to 2007 year to date sales. Exclusive of the Adorn contribution, net sales decreased due to continued softness in the primary market sectors this segment serves. The manufactured housing industry experienced declines of 28% through June 2007, the recreational vehicle industry experienced shipment declines of approximately 13%, and the industrial sector experienced softness as a result of a slowing housing market. The Company estimates that unit volume declines accounted for approximately $16 million of sales in the major products the Company supplies in this segment.

Gross profit. Gross profit decreased $0.4 million, or 3.2%, to $9.8 million in 2007 from $10.2 million in the same period in 2006. As a percent of net sales, gross profit decreased 0.9% to 9.8% in 2007 from 10.7% in 2006. Gross profit increased as a result of approximately $2.0 million in increased contribution from the Adorn acquisition. Decreased sales volumes in primary products in this segment were partially offset by increased average margins on these products from period to period.

Operating income. Operating income decreased $1.4 million, or 30.2%, to $3.2 million in 2007 from $4.6 million in 2006. As a percent of net sales, operating income decreased 1.6% to 3.2% in 2007 from 4.8% in 2006. The Adorn acquisition contributed approximately $0.9 million to operating income in the second quarter of 2007. The decrease in operating income is a result of decreased sales volume exclusive of the Adorn acquisition.

DISTRIBUTION SEGMENT DISCUSSION

Net sales. Net sales decreased $8.1 million, or 13.1%, to $53.7 million in the six-month period ending June 30, 2007 from $61.8 million in the same period in 2006. The decreased sales volume is due to shipment declines of approximately 28% in the manufactured housing industry, which is the primary market sector this segment serves. Unit sales volumes declined approximately 29%, and pricing declined approximately 5% on certain commodity products in this segment from period to period.

Gross profit. Gross profit decreased $0.8 million, or 9.9%, to $6.9 million in 2007 from $7.7 million in the same period in 2006. As a percentage of net sales, gross profit increased approximately 0.4% to 12.9% in 2007 from 12.5% in 2006. The decrease in dollars is attributable to reduced sales volumes and the increase in gross profit as a percent of net sales is due to price increases on certain other commodity products in this segment, margin maintenance, and additional contribution from approximately $3.0 million in new product sales from period to period.

Operating income. Operating income decreased $1.0 million, or 35.2%, to $1.9 million in 2007 from $2.9 million in 2006. The decrease in operating income is attributable to the decrease in sales volume from period to period while fixed costs remained constant.

OTHER COMPONENT MANUFACTURED PRODUCTS SEGMENT DISCUSSION

Net sales. Net sales increased $2.5 million, or 28.0%, to $11.4 million in the six-month period ended June 30, 2007 from $8.9 million in the same period in 2006. The Adorn acquisition contributed approximately $7.1 million in incremental sales to this segment in the second quarter of 2007. Exclusive of the Adorn acquisition, net sales decreased primarily as a result of weakness in both the manufactured housing and recreational vehicle industries in the second quarter of 2007. In the second quarter of 2007 in conjunction with the acquisition of Adorn and its cabinet door facility in Elkhart, Indiana, the Company finalized plans to close and consolidate its Patrick hardwood cabinet door operation in Oregon into this division. The Company expects to lose approximately $4.0 million in annualized sales volume as a result of this consolidation due primarily to logistics and contribution levels.

Gross profit. Gross profit increased $0.1 million, or 9.7%, to $1.3 million in 2007 from $1.2 million in 2006. As a percent of net sales, gross profit decreased 1.9% to 11.2% in 2007 from 13.1% in 2006. The increased gross profit dollars are due to the incremental volume and profitability from the Adorn acquisition and its state of the art cabined door facility and vinyl printing facility in the second quarter of 2007, while the decrease in percentage of net sales is attributable to increased operating losses in the Company s hardwood cabinet door division in 2007.

Operating income. Operating income increased $0.2 million to $0.4 million in 2007 from $0.2 million in the same period in 2006. As a percent of net sales, operating income increased 1.3% to 3.3% in 2007 from 2.0% in 2006. The increase in operating income is attributable to the additional contribution related to the six weeks of activity from the Adorn operating units. The Company s Patrick hardwood cabinet door division incurred operating losses of approximately $0.6 million through June 2007. A decision was made to close this unprofitable division in the second quarter of 2007 and consolidate a portion of its business into Adorn s profitable state-of-the-art cabinet door facility in Elkhart, Indiana.

ENGINEERED SOLUTIONS SEGMENT DISCUSSION

Net sales. Net sales increased $5.1 million, or 20.4%, to $30.2 million 2007 from $25.1 million in the same period in 2006. The increased sales volume is attributable to increased unit sales in this segment of approximately 13%, and increased raw aluminum prices of approximately 10% from period to period.

Gross profit. Gross profit decreased approximately $0.4 million, or 15.8%, to $1.9 million in 2007 from $2.3 million in 2006. As a percent of net sales, gross profit decreased 2.7% to 6.4% in 2007 from 9.1% in 2006. The decrease in gross profit from period to period is due to several factors including pricing pressures from customers due to soft industrial, housing, and recreational vehicle market conditions, increased fuel costs, and increased costs associated with the start-up of the Company s new $4.5 million powder coat paint facility. The Company expects soft market conditions in the aluminum extrusion market for the remainder of 2007.

Operating income. Operating income decreased $0.4 million to $0.8 million in 2007 from $1.2 million in the same period in 2006 due to the factors described above.

LIQUIDITY AND CAPITAL RESOURCES

The Company s primary capital requirements are to meet working capital needs, support its capital expenditure plans, and meet debt service requirements.

Prior to May 18, 2007, the Company maintained a secured bank revolving credit agreement which provided loan availability of $15.0 million and maturity in the year 2009. Interest on this note was at prime or the Eurodollar rate plus a percentage based on the Company s cash flow. The Company paid a commitment fee of between 0.25% and 0.375% of the unused portion of the revolving line based on the Company s cash flow. The agreement was secured by all of the Company s assets.

In January 2007, the Company secured a term note for $7.5 million in conjunction with the American Hardwoods Inc. acquisition. Interest on this note was at prime or the Eurodollar rate plus a percentage based on our cash flow. This note provided for a five year maturity in January 2012 and a ten-year amortization schedule with monthly principal and interest payments due at the end of each month which began in February 2007.

In April 2007, in conjunction with the addition of the new paint line facility and equipment, the Company issued $4.5 million in industrial revenue bonds. These bonds were purchased by JPMorgan Chase and are subject to the terms of a loan agreement with JPMorgan Chase. The bonds bear interest at a variable tax-exempt bond rate with principal and interest payments due monthly over five years and covenants consistent with the Company s revolving credit agreement. The loan agreement is subject to a five year amortization period with a balloon payment in April 2012.

In May 2007, the Company completed the acquisition of Adorn, LLC. The acquisition was funded through both debt and equity financing, which was structured to provide additional liquidity to facilitate the combined companies future growth plans and working capital needs. In connection with the Adorn acquisition, the Company entered into an eight bank syndication agreement led by JPMorgan Securities Inc. and JPMorgan Chase Bank, N.A. for a $110 million senior secured credit facility comprised of revolving credit availability of $35 million and a term loan of $75 million. The credit facility expires on May 18, 2012 and replaces the Company s previous credit facility and related term loans. The Company kept the outstanding industrial revenue bonds in place in conjunction with this new credit facility and is therefore part of the consolidated debt package. The credit facility bears interest at either prime or the Eurodollar rate plus the Company s credit spread which is based on cash flow leverage. The term-debt and revolving credit loans may be repaid at any time without penalty. Interest payments are due monthly with quarterly principal payments beginning in September 2007. In order to reduce its vulnerability to variable interest rates, this package includes an interest rate swap agreement with interest fixed at a rate of 4.78% for approximately $12.9 million of term-debt at May 18, 2007. In July 2007, the Company entered into a second interest rate swap agreement on approximately $10.0 million of term-debt to fix interest at a rate of 5.60%. The unused portion of the revolving credit facility is subject to a commitment fee of between 0.25% and 0.50% annually. The Company incurred approximately $2.2 million in financing costs as part of this transaction. Pursuant to the Credit Agreement, the Company is required to maintain certain financial ratios including a leverage ratio, a debt service coverage ratio, and other financial ratios, all of which are effective beginning in the third quarter of 2007. Obligations under the credit facility are secured by essentially all of the tangible and intangible assets of the Company.

In June 2007, the Company entered into an agreement with one of its suppliers to sell a portion of its inventory back in return for a vendor managed inventory program. In conjunction with this agreement, the Company received approximately $9.4 million in proceeds which were used to pay down its term loan.

Additional financing for the Adorn acquisition was provided by Tontine Capital Partners, L.P. and its affiliates (Tontine). Tontine, a significant shareholder of Patrick, purchased 980,000 shares of Patrick common stock in a private

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Net income (loss)	13,167	(48)
Net income attributable to non-controlling interest	1,118	—
Net income (loss) attributable to common shareholders	12,049	(48)
Earnings per share:		
Net income attributable to common shareholders (basic/diluted)	0.77	NM
Dividends declared per common share	0.78	—
Weighted average number of shares of common stock:		
Basic	15,685	NM
Diluted	17,111	NM

NM = not meaningful

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

INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
For the three months ended March 31, 2010
(Unaudited)

$ in thousands, except per share amounts	Common Stock Shares	Common Stock Amount	Additional Paid in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings (Deficit)	Total Shareholders Equity	Non-Controlling Interest	Total Equity	Comprehensive Income (Loss)
	Attributable to Common Shareholders								
Balance at January 1, 2010	8,887,212	89	172,385	7,721	320	180,515	29,795	210,310	26,470
Net income	—	—	—	—	12,049	12,049	1,118	13,167	13,167
Comprehensive income									
Change in net unrealized gains and losses on available for sale securities	—	—	—	4,531	—	4,531	1,035	5,566	5,566
Change in net unrealized gains and losses on derivatives	—	—	—	(4,719)	—	(4,719)	(627)	(5,346)	(5,346)
Total comprehensive income									39,857
Net proceeds from common stock, net of offering costs	8,050,000	81	162,501	—	—	162,582	—	162,582	
Stock awards to directors	834	—	—	—	—	—	—	—	
Common stock dividends	—	—	—	—	(13,212)	(13,212)	—	(13,212)	
Common unit dividends	—	—	—	—	—	—	(1,112)	(1,112)	
Amortization of equity-based compensation	—	—	18	—	—	18	3	21	
Balance at March 31, 2010	16,938,046	170	334,904	7,533	(843)	341,764	30,212	371,976	

The accompanying notes are an integral part of this consolidated financial statement.

INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

$ in thousands	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009
Cash Flows from Operating Activities		
Net income (loss)	13,167	(48)
Adjustments to reconcile net income to net cash provided by operating activities		
Amortization of mortgage-backed securities premiums and discounts, net	(1,925)	—
Unrealized loss on derivatives	25	—
Gain on sale of mortgage-backed securities	(733)	—
Loss on other-than-temporarily impaired securities	124	—
Equity in earnings and fair value change in unconsolidated limited partnerships	(446)	—
Amortization of equity-based compensation	21	—
Changes in operating assets and liabilities		
Increase in accrued interest	(2,752)	—
(Increase) decrease in prepaid insurance	346	—
(Increase) decrease in deferred offering costs	20	(235)
Increase in other assets	480	—
Increase in accrued interest payable	379	—
Increase in due to affiliate	529	283
Increase (decrease) in accounts payable and accrued expenses	324	—
Net cash provided by operating activities	9,559	—
Cash Flows from Investing Activities		
Purchase of mortgage-backed securities	(775,561)	—
Investment in PPIP	(11,771)	—
Principal payments of mortgage-backed securities	65,868	—
Proceeds from sale of mortgage-backed securities	74,849	—
Net cash used in investing activities	(646,615)	—
Cash Flows from Financing Activities		
Proceeds from issuance of common stock	162,582	—
Restricted cash	(16,182)	—
Proceeds from repurchase agreements	2,527,880	—
Principal repayments of repurchase agreements	(2,112,692)	—
Proceeds from TALF financing	71,525	—
Principal payments of TALF financing	(84)	—
Payments of dividends and distributions	(10,828)	—
Net cash provided by financing activities	622,201	—
Net change in cash	(14,855)	—
Cash, Beginning of Period	24,041	1

Cash, End of Period	9,186	1
Supplement disclosure of cash flow information		
Interest paid	3,273	—
Non-cash investing and financing activities information		
Net change in unrealized gain (loss) on available-for-sale securities and derivatives	220	—
Net change in investment in PPIP	12,339	—
Dividends and distributions declared not paid	14,323	—

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

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INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Note 1 – Organization and Business Operations

Invesco Mortgage Capital Inc. (the “Company”) is a Maryland corporation focused on investing in, financing and managing residential and commercial mortgage-backed securities and mortgage loans. The Company invests in residential mortgage-backed securities (“RMBS”) for which a U.S. Government agency such as the Government National Mortgage Association (“Ginnie Mae”), the Federal National Mortgage Association (“Fannie Mae”) or the Federal Home Loan Mortgage Corporation (“Freddie Mac”) guarantees payments of principal and interest on the securities (collectively “Agency RMBS”). The Company’s Agency RMBS investments include mortgage pass-through securities and collateralized mortgage obligations (“CMOs”). The Company also invests in residential mortgage-backed securities that are not issued or guaranteed by a U.S. government agency (“Non-Agency RMBS”), commercial mortgage-backed securities (“CMBS”), and residential and commercial mortgage loans. The Company is externally managed and advised by Invesco Advisers, Inc. (the “Manager”), a registered investment adviser and an indirect, wholly-owned subsidiary of Invesco Ltd. (“Invesco”), a global investment management company.

The Company conducts its business through IAS Operating Partnership LP (the “Operating Partnership”) as its sole general partner. As of March 31, 2010, the Company owned 92.2% of the Operating Partnership and Invesco Investments (Bermuda) Ltd., a direct, wholly-owned subsidiary of Invesco, owned the remaining 7.8%.

The Company finances its Agency RMBS and Non-Agency RMBS and some of its CMBS investments, through short-term borrowings structured as repurchase agreements. The Manager has secured commitments for the Company with a number of repurchase agreement counterparties. In addition, the Company has financed its CMBS portfolio with financings under the Term Asset-Backed Securities Lending Facility (“TALF”). The Company has also financed, and may do so again in the future, investments in CMBS under private equity sources. The Company also finances its investments in certain Non-Agency RMBS, CMBS and residential and commercial mortgage loans by contributing capital to a partnership that invests in public-private investment funds (“PPIF”) managed by the Company’s Manager. In addition, the Company may use other sources of financing including committed borrowing facilities and other private financing.

The Company intends to elect and qualify to be taxed as a real estate investment trust (“REIT”) for U.S. federal income tax purposes under the provisions of the Internal Revenue Code of 1986, as amended (“Code”), commencing with the Company’s taxable year ended December 31, 2009. To maintain the Company’s REIT qualification, the Company is generally required to distribute at least 90% of its net income (excluding net capital gains) to its shareholders annually.

Note 2 – Summary of Significant Accounting Policies

Basis of Quarterly Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“US GAAP”) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. In the opinion of management, all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation of the financial position and the results of operations of the Company for the interim periods presented have been included. The interim consolidated financial statements should be read in conjunction with the Company’s consolidated financial statements and related notes thereto included in the Company’s annual report on Form 10-K for the year ended December 31, 2009 which was filed with the Securities and Exchange Commission (the “SEC”) on March 24, 2010 and amended on April 29, 2010. The results of operations for the interim period ended March 31, 2010 are not necessarily indicative of the results to be expected for the full year or any other future period.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries. All intercompany balances and transactions have been eliminated.

Use of Estimates

The accounting and reporting policies of the Company conform to US GAAP. The preparation of consolidated financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Examples of estimates include, but are not limited to, estimates of the fair values of financial instruments, interest income on mortgage-backed securities ("MBS") and other-than-temporary impairment charges. Actual results may differ from those estimates.

Cash and Cash Equivalents

The Company considers all highly liquid investments that have original or remaining maturity dates of three months or less when purchased to be cash equivalents. At March 31, 2010, the Company had cash and cash equivalents, including amounts restricted, in excess of the Federal Deposit Insurance Corporation deposit insurance limit of $250,000 per institution. The Company mitigates its risk by placing cash and cash equivalents with major financial institutions.

Deferred Offering Costs

The Company records costs associated with stock offerings as a reduction in additional paid in capital. At December 31, 2009, deferred offering costs consisted of legal and other costs of approximately $288,000 related to the follow-on public offering completed on January 15, 2010 (the "January Offering").

Underwriting Commissions and Costs

Underwriting commissions and direct costs incurred in connection with the Company's initial public offering ("IPO") and the January Offering are reflected as a reduction of additional paid-in-capital.

Repurchase Agreements

The Company finances its Agency RMBS, Non-Agency RMBS and CMBS investment portfolio 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.

In instances where the Company acquires Agency RMBS, Non-Agency RMBS or CMBS through repurchase agreements with the same counterparty from whom the Agency RMBS, Non-Agency RMBS or CMBS were purchased, the Company accounts for the purchase commitment and repurchase agreement on a net basis and records a forward commitment to purchase Agency RMBS, Non-Agency RMBS or CMBS as a derivative instrument if the transaction does not comply with the criteria for gross presentation. All of the following criteria must be met for gross presentation in the circumstance where the repurchase assets are financed with the same counterparty as follows:

- the initial transfer of and repurchase financing cannot be contractually contingent;
- the repurchase financing entered into between the parties provides full recourse to the transferee and the repurchase price is fixed;
- the financial asset has an active market and the transfer is executed at market rates; and
- the repurchase agreement and financial asset do not mature simultaneously.

For assets representing available-for-sale investment securities, which are the case with respect to the Company's portfolio of investments, any change in fair value is reported through consolidated other comprehensive income (loss) with the exception of impairment losses, which are recorded in the consolidated statement of operations.

If the transaction complies with the criteria for gross presentation, the Company records the assets and the related financing on a gross basis on its balance sheet, and the corresponding interest income and interest expense in its statements of operations. Such forward commitments are recorded at fair value with subsequent changes in fair value recognized in income. Additionally, the Company records the cash portion of its investment in Agency RMBS and Non-Agency RMBS as a mortgage related receivable from the counterparty on its balance sheet.

Fair Value Measurements

In January 2010, the FASB updated guidance entitled, "Improving Disclosures about Fair Value Measurements." The guidance required a number of additional disclosures regarding fair value measurements. Specifically, entities should disclose: (1) the amount of significant transfers between Level 1 and Level 2 of the fair value hierarchy and the reasons for these transfers; (2) the reasons for any transfers in or out of Level 3; and (3) information in the reconciliation of recurring Level 3 measurements about purchases, sales, issuances and settlements on a gross basis. Except for the requirement to disclose information about purchases, sales, issuances, and settlements in the reconciliation of recurring Level 3 measurements on a gross basis, all the amendments are effective for interim and annual reporting periods beginning after December 15, 2009. The Company adopted these provisions in preparing the Consolidated Financial Statements for the period ended March 31, 2010. The adoption of these provisions only affected the disclosure requirements for fair value measurements and as a result had no impact on the Company's consolidated statements of operations and consolidated balance sheets.

The Company discloses the fair value of its financial instruments according to a fair value hierarchy (levels 1, 2, and 3, as defined). In accordance with US GAAP, the Company is required to provide enhanced disclosures regarding instruments in the level 3 category (which require significant management judgment), including a separate reconciliation of the beginning and ending balances for each major category of assets and liabilities.

Additionally, US GAAP permits entities to choose to measure many financial instruments and certain other items at fair value (the "fair value option"). Unrealized gains and losses on items for which the fair value option has been elected are irrevocably recognized in earnings at each subsequent reporting date.

During 2009, the Company elected the fair value option for its investments in unconsolidated limited partnerships. The Company has the one-time option to elect fair value for these financial assets on the election date. The changes in the fair value of these instruments are recorded in equity in earnings and fair value change in unconsolidated limited partnerships in the consolidated statements of operations.

Securities

The Company designates securities as held-to-maturity, available-for-sale, or trading depending on its ability and intent to hold such securities to maturity. Trading and securities available-for-sale are reported at fair value, while securities held-to-maturity are reported at amortized cost. Although the Company generally intends to hold most of its RMBS and CMBS until maturity, the Company may, from time to time, sell any of its RMBS or CMBS as part of its overall management of its investment portfolio and as such will classify its RMBS and CMBS as available-for-sale securities.

All securities classified as available-for-sale are reported at fair value, based on market prices from third-party sources, with unrealized gains and losses excluded from earnings and reported as a separate component of shareholders' equity. When applicable, included with available-for-sale securities are forward purchase commitments on to be announced securities ("TBA"). The Company records TBA purchases on the trade date and the corresponding payable is recorded as an outstanding liability in payable for investments purchased until the settlement date of the transaction.

The Company evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market conditions 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 (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of recovery, in fair value of the security, and (iii) the Company's intent and ability to retain its investment in the security for a period of time sufficient to allow for any anticipated recovery in fair value. For debt securities, the amount of the other-than-temporary impairment related to a credit loss or impairments on securities that the Company has the intent or for which it is more likely than not that the Company will need to sell before recovery are recognized in earnings and reflected as a reduction in the cost basis of the security. The amount of the other-than-temporary impairment on debt securities related to other factors is recorded consistent with changes in the fair value of all other available-for-sale securities as a component of consolidated shareholders' equity in other comprehensive income or loss with no change to the cost basis of the security.

Interest Income Recognition

Interest income on available-for-sale MBS, which includes accretion of discounts and amortization of premiums on such MBS, is recognized over the life of the investment using the effective interest method. Management estimates, at the time of purchase, the future expected cash flows and determines the effective interest rate based on these estimated cash flows and the Company's purchase price. As needed, these estimated cash flows are updated and a revised yield is computed based on the current amortized cost of the investment. In estimating these cash flows, there are a number of assumptions subject to uncertainties and contingencies, including the rate and timing of principal payments (prepayments, repurchases, defaults and liquidations), the pass through or coupon rate and interest rate fluctuations. In addition, interest payment shortfalls due to delinquencies on the underlying mortgage loans have to be judgmentally estimated. These uncertainties and contingencies are difficult to predict and are subject to future events that may impact management's estimates and its interest income. Security transactions are recorded on the trade date. Realized gains and losses from security transactions are determined based upon the specific identification method and recorded as gain (loss) on sale of available-for-sale securities in the consolidated statement of operations.

Investments in Unconsolidated Limited Partnerships

The Company has investments in unconsolidated limited partnerships. In circumstances where the Company has a non-controlling interest but is deemed to be able to exert influence over the affairs of the enterprise the Company utilizes the equity method of accounting. Under the equity method of accounting, the initial investment is increased each period for additional capital contributions and a proportionate share of the entity's earnings and decreased for cash distributions and a proportionate share of the entity's losses.

The Company elected the fair value option for investments in unconsolidated limited partnerships. The election for investments in unconsolidated limited partnerships was made upon their initial recognition in the financial statements. The Company has elected the fair value option for the investments in unconsolidated limited partnerships for the purpose of enhancing the transparency of its financial condition.

The Company measures the fair value of the investments in unconsolidated limited partnerships on the basis of the net asset value per share of the investments as permitted in guidance effective for the interim and annual periods ended after December 15, 2009.

Dividends and Distributions Payable

Dividends and distributions payable represent dividends declared at the balance sheet date which are payable to common shareholders and distributions declared at the balance sheet date which are payable to non-controlling interest common unit holders of the Operating Partnership, respectively.

Earnings per Share

The Company calculates basic earnings per share by dividing net income for the period by weighted-average shares of the Company's common stock outstanding for that period. Diluted income per share takes into account the effect of dilutive instruments, such as units of limited partnership interest in the Operating Partnership ("OP Units"), stock options and unvested restricted stock, but uses the average share price for the period in determining the number of incremental shares that are to be added to the weighted-average number of shares outstanding. For the three months ended March 31, 2009, earnings per share is not presented because it is not a meaningful measure of the Company's performance.

Comprehensive Income

Comprehensive income is comprised of net income, as presented in the consolidated statements of operations, adjusted for changes in unrealized gains or losses on available for sale securities and changes in the fair value of derivatives accounted for as cash flow hedges.

Accounting for Derivative Financial Instruments

US GAAP provides disclosure requirements for derivatives and hedging activities with the intent to provide users of financial statements with an enhanced understanding of: (i) how and why an entity uses derivative instruments; (ii) how derivative instruments and related hedged items are accounted for; and (iii) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. US GAAP requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about the fair value of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative instruments.

The Company records all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative, whether the Company has elected to designate a derivative in a hedging relationship and apply hedge accounting and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. Derivatives designated and qualifying as a hedge of the exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Derivatives designated and qualifying as a hedge of the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. Derivatives may also be designated as hedges of the foreign currency exposure of a net investment in a foreign operation. Hedge accounting generally provides for the matching of the timing of gain or loss recognition on the hedging instrument with the recognition of the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk in a fair value hedge or the earnings effect of the hedged forecasted transactions in a cash flow hedge. The Company may enter into derivative contracts that are intended to economically hedge certain of its risk, even though hedge accounting does not apply or the Company elects not to apply hedge accounting under US GAAP.

Income Taxes

The Company intends to elect and qualify to be taxed as a REIT, commencing with the Company's taxable year ended December 31, 2009. Accordingly, the Company will generally not be subject to U.S. federal and applicable state and local corporate income tax to the extent that the Company makes qualifying distributions to its shareholders, and provided the Company satisfies on a continuing basis, through actual investment and operating results, the REIT requirements including certain asset, income, distribution and stock ownership tests. If the Company fails to qualify as a REIT, and does not qualify for certain statutory relief provisions, it will be subject to U.S. federal, state and local income taxes and may be precluded from qualifying as a REIT for the subsequent four taxable years following the year in which the Company lost its REIT qualification. Accordingly, the Company's failure to qualify as a REIT could have a material adverse impact on its results of operations and amounts available for distribution to its shareholders.

A REIT's dividend paid deduction for qualifying dividends to the Company's shareholders is computed using its taxable income as opposed to net income reported on the consolidated financial statements. Taxable income, generally, will differ from net income reported on the consolidated financial statements because the determination of taxable income is based on tax regulations and not financial accounting principles.

The Company may elect to treat certain of its future subsidiaries as taxable REIT subsidiaries ("TRS"). In general, a TRS may hold assets and engage in activities that the Company cannot hold or engage in directly and generally may engage in any real estate or non-real estate-related business. A TRS is subject to U.S. federal, state and local corporate income taxes.

While a TRS will generate net income, a TRS can declare dividends to the Company which will be included in its taxable income and necessitate a distribution to its shareholders. Conversely, if the Company retains earnings at a TRS level, no distribution is required and the Company can increase book equity of the consolidated entity. The Company has no adjustments regarding its tax accounting treatment of any uncertainties. The Company expects to recognize interest and penalties related to uncertain tax positions, if any, as income tax expense, which will be included in general and administrative expense.

Share-Based Compensation

Share-based compensation arrangements include share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. Compensation cost relating to share-based payment transactions are recognized in the consolidated financial statements, based on the fair value of the equity or liability instruments issued on the date of grant, for awards to the Company's independent directors. Compensation related to stock awards to officers and employees of the Manager are recorded at the estimate fair value of the award during the vesting period. The Company makes an upward or downward adjustment to compensation expense for the difference in the fair value at the date of grant and the date the award was earned.

On July 1, 2009, the Company adopted an equity incentive plan under which its independent directors, as part of their compensation for serving as directors, are eligible to receive quarterly restricted stock awards. In addition, the Company may compensate its officers and employees of the Manager under this plan pursuant to the management agreement.

Note 3 – Mortgage-Backed Securities

All of the Company's MBS are classified as available-for-sale and, as such, are reported at fair value, determined by obtaining valuations from an independent source. If the fair value of a security is not available from a dealer or third-party pricing service, or such data appears unreliable, the Company may estimate the fair value of the security using a variety of methods including other pricing services, repurchase agreement pricing, discounted cash flow analysis, matrix pricing, option adjusted spread models and other fundamental analysis of observable market factors. At March 31, 2010, all of the Company's MBS values were based on third-party values. The following tables present certain information about the Company's investment portfolio at March 31, 2010 and December 31, 2009.

March 31, 2010 $ in thousands	Principal Balance	Unamortized Premium (Discount)	Amortized Cost	Unrealized Gain/ (Loss)	Fair Value	Net Weighted Average Coupon (1)	Average Yield (2)
Agency RMBS:							
15 year fixed-rate	292,729	11,512	304,241	3,276	307,517	4.86%	3.54 %
30 year fixed-rate	342,080	22,672	364,752	870	365,622	5.90%	3.94 %
ARM	9,377	208	9,585	(257)	9,328	3.08%	2.53 %
Hybrid ARM	128,763	6,027	134,790	(353)	134,437	4.98%	2.78 %
Total Agency	772,949	40,419	813,368	3,536	816,904	5.32%	3.58 %
MBS – CMO	23,411	739	24,150	575	24,725	6.33%	4.88 %
Non-Agency MBS	613,798	(241,270)	372,528	6,804	379,332	3.80%	11.58%
CMBS	209,512	(1,861)	207,651	7,393	215,044	5.07%	5.27 %
Total	1,619,670	(201,973)	1,417,697	18,308	1,436,005	4.72%	5.95 %

December 31, 2009 $ in thousands	Principal Balance	Unamortized Premium (Discount)	Amortized Cost	Unrealized Gain/ (Loss)	Fair Value	Net Weighted Average Coupon (1)	Average Yield (2)
Agency RMBS:							
15 year fixed-rate	251,752	9,041	260,793	1,023	261,816	4.82 %	3.80 %
30 year fixed-rate	149,911	10,164	160,075	990	161,065	6.45 %	5.02 %
ARM	10,034	223	10,257	(281)	9,976	2.52 %	1.99 %
Hybrid ARM	117,163	5,767	122,930	597	123,527	5.14 %	3.55 %
Total Agency	528,860	25,195	554,055	2,329	556,384	5.31 %	4.07 %
MBS – CMO	27,819	978	28,797	936	29,733	6.34 %	4.83 %
Non-Agency MBS	186,682	(79,341)	107,341	7,992	115,333	4.11 %	17.10 %
CMBS	104,512	(4,854)	99,658	1,484	101,142	4.93 %	5.97 %
Total	847,873	(58,022)	789,851	12,741	802,592	5.03 %	6.10 %

(1) Net weighted average coupon (“WAC”) is presented net of servicing and other fees.
(2) Average yield incorporates future prepayment and loss assumptions.

The components of the carrying value of the Company's investment portfolio at March 31, 2010 and December 31, 2009 are presented below.

$ in thousands	March 31, 2010	December 31, 2009
Principal balance	1,619,670	847,873
Unamortized premium	43,549	26,174
Unamortized discount	(245,522)	(84,196)
Gross unrealized gains	28,133	14,595
Gross unrealized losses	(9,825)	(1,854)
Fair value	1,436,005	802,592

The following table summarizes certain characteristics of the Company's investment portfolio, at fair value, according to estimated weighted average life classifications as of March 31, 2010:

$ in thousands	March 31, 2010	December 31, 2009
Less than one year	1,382	—
Greater than one year and less than five years	813,500	483,540
Greater than or equal to five years	621,123	319,052
Total	1,436,005	802,592

The Company assesses its investment securities for other-than-temporary impairment on at least a quarterly basis. When the fair value of an investment is less than its amortized cost at the balance sheet date of the reporting period for which impairment is assessed, the impairment is designated as either "temporary" or "other-than-temporary." In deciding on whether or not a security is other than temporarily impaired, the Company considers several factors, including the nature of the investment, the severity and duration of the impairment, the cause of the impairment, and the Company's intent that it is more likely than not that the Company can hold the security until recovery of its cost basis.

During the three months ended March 31, 2010, the trustees of certain non-Agency RMBS notified the Company that due to the deterioration in the credit quality of the underlying collateral in these securitizations, a portion of the principal of these securities had no value. Accordingly, the Company recognized a $124,000 loss on other-than-temporarily impaired securities in the consolidated statement of operations for the three months ended March 31, 2010, which had been included in accumulated other comprehensive income.

The following tables present the gross unrealized losses and estimated fair value of the Company's RMBS by length of time that such securities have been in a continuous unrealized loss position at March 31, 2010 and December 31, 2009, respectively:

March 31, 2010	Less than 12 Months		12 Months or More		Total	
$ in thousands	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses

Agency RMBS:						
15 year fixed-rate	26,814	(70)	—	—	26,814	(70)
30 year fixed-rate	182,629	(1,277)	—	—	182,629	(1,277)
ARM	9,328	(257)	—	—	9,328	(257)
Hybrid ARM	66,962	(706)	—	—	66,962	(706)
Total Agency	285,733	(2,310)	—	—	285,733	(2,310)
MBS – CMO	8,111	(50)	—	—	8,111	(50)
Non-Agency MBS	225,759	(7,131)	—	—	225,759	(7,131)
CMBS	41,159	(334)	—	—	41,159	(334)
Total	560,762	(9,825)	—	—	560,762	(9,825)

December 31, 2009	Less than 12 Months		12 Months or More		Total	
$ in thousands	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Agency RMBS:						
15 year fixed-rate	42,446	(82)	—	—	42,446	(82)
30 year fixed-rate	22,195	(70)	—	—	22,195	(70)
ARM	9,976	(281)	—	—	9,976	(281)
Hybrid ARM	—	—	—	—	—	—
Total Agency	74,617	(433)	—	—	74,617	(433)
MBS – CMO	—	—	—	—	—	—
Non-Agency MBS	13,499	(1,044)	—	—	13,499	(1,044)
CMBS	18,281	(376)	—	—	18,281	(376)
Total	106,397	(1,853)	—	—	106,397	(1,853)

Note 4 – Investments in Unconsolidated Limited Partnerships

Invesco Mortgage Recovery Feeder Fund, L.P. and Invesco Mortgage Recovery Loans AIV, L.P.

The Company invested in certain Non-Agency RMBS, CMBS and residential and commercial mortgage loans by contributing equity capital to a legacy securities PPIF established and managed by the Manager or one of its affiliates, Invesco Mortgage Recovery Feeder Fund, L.P. (the “Fund”) that receives financing under the U.S. government’s Public-Private Investment Program (“PPIP”). In addition the Manager identified a whole loan transaction, which resulted in the Company being admitted into an alternative investment vehicle, the Invesco Mortgage Recovery Loans AIV, L.P. (an “AIV”). The Company’s initial commitment in the Fund and AIV was $25.0 million. The Fund and AIV limited partnership agreements provided for additional subscriptions of limited partners within six months of the initial closing. During 2009 and 2010 the Fund and AIV accepted additional subscriptions and the Company increased its overall commitment to $100.0 million which effectively increased the Company’s initial ownership interest in the Fund and AIV. In connection with the increase of the Company’s interest in the Fund and AIV, the Company is committed to fund approximately $12.1 million of additional capital at March 31, 2010. The Company realized approximately $230,000 of equity in earnings and $216,000 of unrealized appreciation from these investments for the three months ended March 31, 2010.

The Company’s non-controlling, unconsolidated ownership interests in these entities are accounted for under the equity method. Capital contributions, distributions, and profit and losses of the entity are allocated in accordance with the terms of the partnership agreement. Such allocations may differ from the stated percentage interests, if any, as a result of preferred returns and allocation formulas as described in such agreements. The Company has made the fair value election for both investments in unconsolidated limited partnerships. The fair value measurement for the investment in unconsolidated limited partnerships is based on the net asset value per share of the investment, or its equivalent.

Note 5 – Borrowings

Repurchase Agreements

The Company has entered into repurchase agreements to finance a portion of its portfolio of investments. The repurchase agreements bear interest at a contractually agreed rate. The repurchase obligations mature and reinvest every thirty to ninety days and have a weighted average aggregate interest rate of 0.47% and 0.26% at March 31, 2010 and December 31, 2009, respectively. These repurchase agreements are being accounted for as secured borrowings since the Company maintains effective control of the financed assets. The following table summarizes certain characteristics of the Company's repurchase agreements at March 31, 2010 and December 31, 2009:

$ in thousands	March 31, 2010		December 31, 2009	
	Amount Outstanding	Weighted Average	Amount Outstanding	Weighted Average
Agency RMBS	773,490	0.24 %	545,975	0.26 %
Non-Agency RBS	169,534	1.49 %	—	—
CMBS	18,139	1.05 %	—	—
Total	961,163	0.47 %	545,975	0.26 %

Under the repurchase agreements, the respective lender retains the right to mark the underlying collateral to fair value. A reduction in the value of pledged assets would require the Company to provide additional collateral or fund margin calls.

The following tables summarize certain characteristics of the Company's repurchase agreements at March 31, 2010 and December 31, 2009:

March 31, 2010
$ in thousands

Purchase A greement Counterparties	Amount Outstanding	Percent of Total Amount Outstanding		Company MBS Held as Collateral
Credit Suisse	362,426	38	%	422,698
Barclay's Bank	59,581	6	%	62,610
RBS Securities	127,199	13	%	157,560
Deutsche Bank	77,279	8	%	82,236
Goldman Sachs	173,260	18	%	182,031
BNP Paribas	70,265	7	%	72,613
Wells Fargo	60,605	7	%	62,960
Nomura	30,548	3	%	32,158
Total	961,163	100	%	1,074,866

December 31, 2009
$ in thousands

Purchase Agreement Counterparties	Amount Outstanding	Percent of Total Amount Outstanding		Company MBS Held as Collateral
Credit Suisse	109,697	20	%	110,501
Barclay's Bank	62,279	12	%	64,228
RBS Securities	83,093	15	%	86,503
Deutsche Bank	115,764	21	%	113,804
Goldman Sachs	175,142	32	%	182,731
Total	545,975	100	%	557,767

Cash collateral held by the counterparties at March 31, 2010 and December 31, 2009 were $29.5 million and $14.0 million, respectively.

TALF Financing

Under the TALF, the Federal Reserve made non-recourse loans to borrowers to fund purchases of asset-backed securities ("ABS"). The TALF facility ceased making loans collateralized by newly issued and legacy ABS on March 31, 2010. The Company has secured borrowings of $151.8 million under the TALF at a weighted average interest rate of 3.56% and 3.82% at March 31, 2010 and December 31, 2009, respectively. The TALF loans are non-recourse. However, they are secured by $194.6 million of CMBS, and mature in February 2013, July 2014, August 2014, December 2014 and January 2015.

At March 31, 2010, the TALF financing agreements had the following remaining maturities:

$ in thousands	March 31, 2010
2011	—
2012	—
2013	33,764
2014	80,342
2015	37,713
Thereafter	—
Total	151,819

Note 6 – Derivatives and Hedging Activities

Risk Management Objective of Using Derivatives

The Company is exposed to certain risks arising from both its business operations and economic conditions. The Company principally manages its exposures to a wide variety of business and operational risks through management of its core business activities. The Company manages economic risks, including interest rate, liquidity, and credit risk primarily by managing the amount, sources, and duration of its investments, debt funding, and the use of derivative financial instruments. Specifically, the Company enters into derivative financial instruments to manage exposures that arise from business activities that result in the receipt or payment of future known and uncertain cash amounts, the value of which are determined by interest rates. The Company's derivative financial instruments are used to manage differences in the amount, timing, and duration of the Company's known or expected cash receipts and its known or expected cash payments principally related to the Company's investments and borrowings.

Cash Flow Hedges of Interest Rate Risk

The Company finances its activities primarily through repurchase agreements, which are generally settled on a short-term basis, usually from one to three months. At each settlement date, the Company refinances each repurchase agreement at the market interest rate at that time. Since the interest rate on its repurchase agreements change on a monthly basis, the Company is exposed to changing interest rates. The Company's objectives in using interest rate derivatives are to add stability to interest expense and to manage its exposure to interest rate movements. To accomplish this objective, the Company primarily uses interest rate swaps as part of its interest rate risk management strategy. Interest rate swaps designated as cash flow hedges involve the receipt of variable-rate amounts from a counterparty in exchange for the Company making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount.

The effective portion of changes in the fair value of derivatives designated and qualifying as cash flow hedges is recorded in accumulated other comprehensive income and is subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. The ineffective portion of the change in fair value of the derivatives is recognized directly in earnings. During the three months ended March 31, 2010, the Company recorded $25,000 of unrealized swap losses in earnings as hedge ineffectiveness attributable primarily to differences in the reset dates on the Company's swaps versus the refinancing dates of certain of its repurchase agreements.

Amounts reported in accumulated other comprehensive income related to derivatives will be reclassified to interest expense as interest is accrued and paid on the Company's repurchase agreements. During the next twelve months, the Company estimates that an additional $13.0 million will be reclassified as an increase to interest expense.

The Company is hedging its exposure to the variability in future cash flows for forecasted transactions over a maximum period of 64 months.

As of March 31, 2010, the Company had the following outstanding interest rate derivatives that were designated as cash flow hedges of interest rate risk:

Counterparty	Notional Amount $ - in thousands	Maturity Date	Fixed Interest Rate in Contract
The Bank of New York Mellon	175,000	8/5/2012	2.07 %

SunTrust Bank	100,000	7/15/2014	2.79 %
Credit Suisse International	100,000	2/24/2015	3.26 %
Credit Suisse International	100,000	3/24/2015	2.76 %
The Bank of New York Mellon	100,000	5/24/2013	1.83 %
Wells Fargo Bank, N.A.	100,000	7/15/2015	2.85 %
Total/Weighted Average	675,000		2.54 %

At March 31, 2010, the Company's counterparties held approximately $1.1 million of cash margin deposits and approximately $13.2 million of RMBS as collateral against its swap contracts. The cash is classified as restricted cash and the agency RMBS is included in the total mortgage-backed securities on our consolidated balance sheet.

The table below presents the fair value of the Company’s derivative financial instruments, as well as their classification on the balance sheet as of March 31, 2010 and December 31, 2009.

$ in thousands

Asset Derivatives				Liability Derivatives			
As of March 31, 2010		As of December 31, 2009		As of March 31, 2010		As of December 31, 2009	
Balance Sheet	Fair Value	Balance Sheet	Fair Value	Balance Sheet	Fair Value	Balance Sheet	Fair Value
Interest rate swap asset	44	Interest rate swap asset	—	Interest rate swap liability	9,197	Interest rate swap liability	3,782

Tabular Disclosure of the Effect of Derivative Instruments on the Income Statement

The table below presents the effect of the Company’s derivative financial instruments on the statement of operations for the three months ended March 31, 2010.

$ in thousands

Derivative type for cash flow hedge	Amount of loss recognized in OCI on derivative (effective portion)	Location of loss reclassified from accumulated OCI into income (effective portion)	Amount of loss reclassified from accumulated OCI into income (effective portion)	Location of loss recognized in income on derivative (ineffective portion)	Amount of loss recognized in income on derivative (ineffective portion)
Interest Rate Swap	7,145	Interest Expense	1,799	Other Expense	25

Credit-risk-related Contingent Features

The Company has agreements with each of its derivative counterparties. Some of those agreements contain a provision where if the Company defaults on any of its indebtedness, including default where repayment of the indebtedness has not been accelerated by the lender, then the Company could also be declared in default on its derivative obligations.

The Company has an agreement with one of its derivative counterparties that contains a provision where if the Company’s net asset value declines by certain percentages over specified time periods, then the Company could be declared in default on its derivative obligations. The Company also has an agreement with one of its derivative counterparties that contains a provision where if the Company’s shareholders’ equity declines by certain percentages over specified time periods, then the Company could be declared in default on its derivative obligations.

The Company has an agreement with one of its derivative counterparties that contains a provision where if the Company fails to maintain a minimum shareholders’ equity or market value of $80 million, then the Company could be declared in default on its derivative obligations.

As of March 31, 2010, the fair value of derivatives in a net liability position, which includes accrued interest but excludes any adjustment for nonperformance risk, related to these agreements was $9.7 million. The Company has minimum collateral posting thresholds with certain of its derivative counterparties and has posted collateral of approximately $1.1 million of cash and $13.2 million of RMBS. If the Company had breached any of these provisions at March 31, 2010, it could have been required to settle its obligations under the agreements at their termination value.

Note 7 – Financial Instruments

US GAAP defines fair value, provides a consistent framework for measuring fair value under US GAAP and Accounting Standards Codification (ASC) Topic 820 expands fair value financial statement disclosure requirements. ASC Topic 820 does not require any new fair value measurements and only applies to accounting pronouncements that already require or permit fair value measures, except for standards that relate to share-based payments.

Valuation techniques are based on observable and unobservable inputs. Observable inputs reflect readily obtainable data from independent sources, while unobservable inputs reflect the Company’s market assumptions. These inputs into the following hierarchy:

- Level 1 Inputs – Quoted prices for identical instruments in active markets.

- Level 2 Inputs – Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable or whose significant value drivers are observable.

- Level 3 Inputs – Instruments with primarily unobservable value drivers.

The fair values at March 31, 2010 and December 31, 2009, on a recurring basis, of the Company's MBS and interest rate hedges based on the level of inputs are summarized below:

	March 31, 2010 Fair Value Measurements Using:			
$ in thousands	Level 1	Level 2	Level 3	Total at Fair Value
Assets				
Mortgage-backed securities (1)	—	1,436,005	—	1,436,005
Investments in unconsolidated limited partnerships	—	—	28,683	28,683
Derivatives	—	44	—	44
Total	—	1,436,049	28,638	1,464,732
Liabilities				
Derivatives	—	9,197	—	9,197
Total	—	9,197	—	9,197

	December 31, 2009 Fair Value Measurements Using:			
$ in thousands	Level 1	Level 2	Level 3	Total at Fair Value
Assets				
Mortgage-backed securities (1)	—	802,592	—	802,592
Investments in unconsolidated limited partnerships	—	—	4,128	4,128
Total	—	802,592	4,128	806,720
Liabilities				
Derivatives	—	3,782	—	3,782
Total	—	3,782	—	3,782

(1) For more detail about the fair value of our MBS and type of securities, see Note 3 in the unaudited consolidated financial statements.

The following table presents additional information about the Company's investments in unconsolidated limited partnerships which are measured at fair value on a recurring basis for which the Company has utilized level 3 inputs to determine fair value:

$ in thousands	March 31, 2010	December 31, 2009
Beginning balance	4,128	—
Purchases, sales and settlements, net	24,109	4,057
Total net gains / (losses) included in net income		
Realized gains/(losses), net	230	63
Unrealized gains/(losses), net	216	8
Unrealized gain/(losses), net included in other comprehensive income	—	—
Ending balance	28,683	4,128

The fair value of the TALF debt and repurchase agreements are based on an expected present value technique. This method discounts future estimated cash flows using rates the Company determined best reflect current market interest rates that would be offered for loans with similar characteristics and credit quality. At March 31, 2010, the TALF debt had a fair value of $152.4 million and a carrying value of $151.8 million and the repurchase agreements had a fair value of $961.5 million and a carrying value of $961.2 million. At December 31, 2009, the TALF debt had a fair value of $80.0 million and a carrying value of $80.4 million and the repurchase agreements had a fair value of $546.1 million and a carrying value of $546.0 million.

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Note 8 – Related Party Transactions

The Company is externally managed and advised by the Manager. Pursuant to the terms of the management agreement, effective July 1, 2009, the Manager provides the Company with its management team, including its officers, along with appropriate support personnel. Each of the Company's officers is an employee of Invesco or one of Invesco's affiliates. The Company does not have any employees. With the exception of the Company's Chief Financial Officer, the Manager is not obligated to dedicate any of its employees exclusively to the Company, nor is the Manager or its employees obligated to dedicate any specific portion of its or their time to the Company's business. The Manager is at all times subject to the supervision and oversight of the Company's board of directors and has only such functions and authority as the Company delegates to it.

Management Fee

The Company pays the Manager a management fee equal to 1.50% of the Company's shareholders' equity per annum, which is calculated and payable quarterly in arrears. For purposes of calculating the management fee, shareholders' equity is equal to the sum of the net proceeds from all issuances of equity securities since inception (allocated on a pro rata daily basis for such issuances during the fiscal quarter of any such issuance), plus retained earnings at the end of the most recently completed calendar quarter (without taking into account any non-cash equity compensation expense incurred in current or prior periods), less any amount paid to repurchase common stock since inception, and excluding any unrealized gains, losses or other items that do not affect realized net income (regardless of whether such items are included in other comprehensive income or loss, or in net income). This amount will be adjusted to exclude one-time events pursuant to changes in US GAAP, and certain non-cash items after discussions between the Manager and the Company's independent directors and approval by a majority of the Company's independent directors.

A termination fee is due to the Manager upon termination of the management agreement by the Company equal to three times the sum of the average annual management fee earned by the Manager during the 24-month period prior to such termination, calculated as of the end of the most recently completed fiscal quarter.

The Manager has agreed to reduce (but not below zero) the management fee payable by the Company under the management agreement with respect to any equity investment the Company may make in the Fund managed by the Manager or any of its affiliates. In addition, the Company may include any stock-based compensation awarded to personnel of the Manager as a component of the Manger's compensation.

For the three months ended March 31, 2010, the Company incurred management fees of approximately $1.3 million, of which all was accrued but had not been paid.

Expense Reimbursement

Pursuant to the management agreement, the Company is required to reimburse the Manager for operating expenses related to the Company incurred by the Manager, including certain salary expenses and other expenses related to legal, accounting, due diligence and other services. The Company's reimbursement obligation is not subject to any dollar limitation.

The Company incurred costs, originally paid by Invesco, of approximately $581,000 and $283,000 for the three months ended March 31, 2010 and 2009, respectively. Approximately $344,000 and $48,000 was expensed for the three months ended March 31, 2010 and 2009, respectively, and approximately $237,000 was charged against equity as a cost of raising capital for the three months ended March 31, 2010. During the three months ended March 31, 2009, $235,000 of costs were capitalized as deferred offering costs.

Note 9 – Shareholders' Equity (Deficit)

Securities Convertible into Shares of Common Stock

As of the completion of the Company's IPO on July 1, 2009, (i) the limited partners who hold units of the Operating Partnership ("OP Units") have the right to cause the Operating Partnership to redeem their OP Units for cash equal to the market value of an equivalent number of shares of common stock, or at the Company's option, the Company may purchase their OP Units by issuing one share of common stock for each OP Unit redeemed, and (ii) the Company adopted an equity incentive plan which includes the ability for the Company to grant securities convertible into the Company's common stock to the independent directors and the executive officers of the Company and the personnel of the Manager.

Registration Rights

The Company entered into a registration rights agreement with regard to the common stock and OP Units owned by the Manager and Invesco Investments (Bermuda) Ltd., respectively, upon completion of the Company's IPO and any shares of common stock that the Manager may elect to receive under the management agreement or otherwise. Pursuant to the registration rights agreement, the Company has granted to the Manager and Invesco Investments (Bermuda) Ltd., (i) unlimited demand registration rights to have the shares purchased by the Manager or granted to it in the future and the shares that the Company may issue upon redemption of the OP Units purchased by Invesco Investments (Bermuda) Ltd. registered for resale, and (ii) in certain circumstances, the right to "piggy-back" these shares in registration statements the Company might file in connection with any future public offering so long as the Company retains the Manager under the management agreement. The registration rights of the Manager and Invesco Investments (Bermuda) Ltd., with respect to the common stock and OP Units that they purchased simultaneously with the Company's IPO, will apply on and after June 25, 2010.

Public Offering

On January 15, 2010, the Company completed a public offering of 7,000,000 shares of common stock and an issuance of an additional 1,050,000 shares of common stock pursuant to the underwriters' full exercise of their over-allotment option at $21.25 per share. Net proceeds to the Company were $162.6 million, net of issuance costs of approximately $8.5 million.

Share-Based Compensation

The Company established the 2009 Equity Incentive Plan for grants of restricted common stock and other equity based awards to the independent directors and the executive officers of the Company and personnel of the Manager (the "Incentive Plan"). Under the Incentive Plan, a total of 1,000,000 shares are currently reserved for issuance. Unless terminated earlier, the Incentive Plan will terminate in 2019, but will continue to govern the unexpired awards. The Company recognized compensation expense of approximately $19,000 for the three months ended March 31, 2010. During the three months ended March 31, 2010, the Company issued 834 shares of restricted stock pursuant to this plan to the Company's non-executive directors. The fair market value of the shares granted was determined by the closing stock market price on the date of grant.

On March 17, 2010, the Company awarded 5,725 restricted stock units to the executive officers of the Company who are employees of the Manager. The restricted stock units vest equally in four installments on the anniversary date of each award. Compensation related to stock awards to officers and employees of the Manager are recorded at the estimated fair value of the award during the vesting period. The Company makes an upward or downward adjustment to compensation expense for the difference in the fair value at the date of grant and the date the award was earned. The Company recognized compensation expense of approximately $2,000 for the three months ended March 31, 2010 related to awards to officers and employees of the Manager.

Dividends

On March 18, 2010, the Company declared a dividend of $0.78 per share of common stock. The dividend was paid on April 22, 2010 to shareholders of record as of the close of business on March 31, 2010.

Note 10 – Earnings per Share

Earnings per share for the three months ended March 31, 2010 is computed as follows:

$ in thousands	Three Months Ended March 31, 2010
Numerator (Income)	
Basic Earnings	
Net income available to common shareholders	12,049
Effect of dilutive securities:	
Income allocated to non-controlling interest	1,118
Dilutive net income available to shareholders	13,167
Denominator (Weighted Average Shares)	
Basic Earnings:	
Shares available to common shareholders	15,685
Effect of dilutive securities:	
OP Units	1,426
Dilutive Shares	17,111

For the three months ended March 31, 2009, earnings per share is not presented because it is not a meaningful measure of the Company's performance.

Note 11 – Non-controlling Interest - Operating Partnership

Non-controlling interest represents the aggregate OP Units in the Operating Partnership held by limited partners (the "Unit Holders"). Income allocated to the non-controlling interest is based on the Unit Holders ownership percentage of the Operating Partnership. The ownership percentage is determined by dividing the number of OP Units held by the Unit Holders by the total number of dilutive shares of common stock. The issuance of common stock ("Share" or "Shares") or OP Units changes the percentage ownership of both the Unit Holders and the holders of common stock. Since an OP unit is generally redeemable for cash or Shares at the option of the Company, it is deemed to be equivalent to a Share. Therefore, such transactions are treated as capital transactions and result in an allocation between shareholders' equity and non-controlling interest in the accompanying consolidated balance sheet to account for the change in the ownership of the underlying equity in the Operating Partnership. As of March 31, 2010, non-controlling interest related to the outstanding 1,425,000 OP units represented a 7.76% interest in the Operating Partnership. Income allocated to the Operating Partnership non-controlling interest for the three months ended March 31, 2010 was approximately $1.1 million. Distributions paid and payable to the non-controlling interest were approximately $1.5 million and $1.1 million, respectively.

Note 12 – Subsequent Events

On May 3, 2010, the Company completed a follow-on public offering of 9,000,000 shares of common stock at $20.75 per share. The net proceeds to the Company were $177.5 million, net of issuance costs of approximately $9.2

million. The underwriters have the option to purchase an additional 1,350,000 shares of common stock pursuant to an over-allotment option for 30 days.

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

In this quarterly report on Form 10-Q, or this "Report," we refer to Invesco Mortgage Capital Inc. and its consolidated subsidiaries as "we," "us," "our Company," or "our," unless we specifically state otherwise or the context indicates otherwise We refer to our external manager, Invesco Advisers, Inc., as our "Manager," and we refer to the indirect parent company of our Manager, Invesco Ltd., together with its consolidated subsidiaries (other than us), as "Invesco."

The following discussion should be read in conjunction with our consolidated financial statements and the accompanying notes to our consolidated financial statements, which are included in Item 1 of this report, as well as the information contained in our most recent Form 10-K, as amended filed with the Securities and Exchange Commission (the "SEC").

Forward-Looking Statements

We make forward-looking statements in this Report and other filings we make with the SEC 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, and such statement are intended to be covered by the safe harbor provided by the same. Forward-looking statements are subject to substantial risks and uncertainties, many of which are difficult to predict and are generally beyond our control. These forward-looking statements include information about possible or assumed future results of our business, financial condition, liquidity, results of operations, plans and objectives. When we use the words "believe," "expect," "anticipate," "estimate," "plan," "continue," "intend," "should," "may" or similar expressions, we intenc forward-looking statements. Factors that could cause actual results to differ from those expressed in the Company's forward-looking statements include, but are not limited to:

- actions and initiatives of the U.S. government and changes to U.S. government policies;
- our ability to obtain additional financing arrangements;
- financing and advance rates for our target assets;
- changes to our expected leverage;
- general volatility of the securities markets in which we invest;
- interest rate mismatches between our target assets and our borrowings used to fund such investments;
- changes in interest rates and the market value of our target assets;
- changes in prepayment rates on our target assets;
- effects of hedging instruments on our target assets;
- rates of default or decreased recovery rates on our target assets;
- modifications to whole loans or loans underlying securities;
- the degree to which our hedging strategies may or may not protect us from interest rate volatility;

- changes in governmental regulations, tax law and rates, and similar matters;
- our ability to qualify as a REIT for U.S. federal income tax purposes;

- our ability to maintain our exclusion from the definition of "investment company" under the 1940 Act;
- availability of investment opportunities in mortgage-related, real estate-related and other securities;
- availability of qualified personnel;
- our understanding of our competition; and
- market trends in our industry, interest rates, real estate values, the debt securities markets or the general economy.

These forward-looking statements are based upon information presently available to our management and are inherently subjective, uncertain and subject to change. There can be no assurance that actual results will not differ materially from our expectations. We caution investors not to rely unduly on any forward-looking statements and urge you to carefully consider the risks identified under the captions "Risk Factors," "Forward-Looking Statements" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this Report and the most recent Form 10-K, as amended, which is available on the SEC's website at www.sec.gov.

All written or oral forward-looking statements that we make, or that are attributable to us, are expressly qualified by this cautionary notice. We expressly disclaim any obligation to update the information in any public disclosure if any forward-looking statement later turns out to be inaccurate, except as may otherwise be required by law.

Overview

We are a Maryland corporation focused on investing in, financing and managing residential and commercial mortgage-backed securities and mortgage loans. We are externally managed and advised by Invesco Advisers, Inc. (our "Manager"), which is an indirect, wholly-owned subsidiary of Invesco Ltd. (NYSE:IVZ) ("Invesco"). We intend to qualify to be taxed as a REIT commencing with our taxable year ended December 31, 2009. Accordingly, we generally will not be subject to U.S. federal income taxes on our taxable income that we distribute currently to our shareholders as long as we maintain our qualification as a REIT. We operate our business in a manner that will permit us to maintain our exemption from registration under the Investment Company Act of 1940, as amended (the "1940 Act").

Our objective is to provide attractive risk-adjusted returns to our shareholders, primarily through dividends and secondarily through capital appreciation. To achieve this objective, we invest in the following securities:

- Agency RMBS, which are residential mortgage-backed securities, for which a U.S. government agency such as the Government National Mortgage Association ("Ginnie Mae") or a federally chartered corporation such as the Federal National Mortgage Association ("Fannie Mae") or the Federal Home Loan Mortgage Corporation ("Freddie Mac") guarantees payments of principal and interest on the securities;
- Non-Agency RMBS, which are RMBS that are not issued or guaranteed by a U.S. government agency or a federally chartered corporation;
- CMBS, which are commercial mortgage-backed securities; and
- Residential and commercial mortgage loans.

We finance our investments in Agency RMBS and non-Agency RMBS primarily through short-term borrowings structured as repurchase agreements. In addition, we have financed our investments in CMBS with financing under the Term Asset-Backed Securities Loan Facility (“TALF”). We have also financed, and may do so again in the future, our investments in CMBS with private financing sources. We have also financed our investments in certain non-Agency RMBS, CMBS and residential and commercial mortgage loans by contributing capital to one or more of the legacy securities public-private investment funds (“PPIFs”) that receive financing under the U.S. government’s Public-Private Investment Program (“PIPP”), established and managed by our Manager or one of its affiliates (the “Invesco PPIP Fund”), which, in turn, invests in our target assets.

Recent Developments

On May 3, 2010, we completed a follow-on public offering of 9,000,000 shares of common stock at $20.75 per share. The net proceeds to us were $177.5 million, net of issuance costs of approximately $9.2 million. The underwriters have the option to purchase an additional 1,350,000 shares of common stock pursuant to an over-allotment option for 30 days.

On January 15, 2010, we completed a follow-on public offering of 7,000,000 shares of common stock and an issuance of an additional 1,050,000 shares of common stock pursuant to the underwriters' full exercise of their over-allotment option at $21.25 per share. The net proceeds to us were $162.6 million, net of issuance costs of approximately $8.5 million.

We have actively worked to deploy the proceeds from our follow-on offering. As of March 31, 2010:

- We invested the net proceeds from our follow-on public offering, as well as monies that we borrowed under repurchase agreements and TALF, to increase our investment portfolio to approximately $1.4 billion, which consisted of $816.9 million in Agency RMBS, $379.3 million in Non-Agency RMBS, $215.0 million in CMBS and $24.7 million in CMOs.

- We borrowed an aggregate $961.2 million (an increase of $415.2 million during the first quarter 2010) under our master repurchase agreements at a weighted average rate of 0.47%, of which $773.5 million was used to purchases Agency RMBS at a weighted average of rate of 0.24%, $170.0 million for Non-Agency RMBS at a weighted average rate of 1.49% and $18.1 million for CMBS at a weighted average rate of 1.05%.

- We entered into three additional interest rate swap agreements, for a notional amount of $300.0 million, increasing our holdings to six interest rate swap agreements and total notional amount to $675.0 million. The interest rate swap agreements are designed to mitigate the effects of increases in interest rates under a portion of our repurchase agreements.

- We increased our borrowings by $71.4 million under the TALF to $151.8 million at a weighted average interest rate of 3.56%.

- We increased our commitment from $25.0 million to invest up to $100.0 million in the Invesco PPIP Fund which, in turn, invests in our target assets. As of March 31, 2010, $28.4 million has been called, which is an increase of $24.3 million from December 31, 2009.

Factors Impacting Our Operating Results

Our operating results can be affected by a number of factors and primarily depend on, among other things, the level of our net interest income, the market value of our assets and the supply of, and demand for, the target assets in which we invest. Our net interest income, which includes the amortization of purchase premiums and accretion of purchase discounts, varies primarily as a result of changes in market interest rates and prepayment speeds, as measured by the constant prepayment rate (“CPR”) on our target assets. Interest rates and prepayment speeds vary according to the type of investment, conditions in the financial markets, competition and other factors, none of which can be predicted with any certainty.

Market Conditions

Beginning in the summer of 2007, significant adverse changes in financial market conditions resulted in a deleveraging of the entire global financial system. As part of this process, residential and commercial mortgage markets in the United States experienced a variety of difficulties, including loan defaults, credit losses and reduced liquidity. As a result, many lenders tightened their lending standards, reduced lending capacity, liquidated significant portfolios or exited the market altogether, and therefore, financing with attractive terms was generally unavailable. In response to these unprecedented events, the U.S. government has taken a number of actions to stabilize the financial markets and encourage lending. Significant measures include the enactment of the Emergency Economic Stabilization Act of 2008 to, among other things, establish the Troubled Asset Relief Program, or TARP, the enactment of the Housing and Economic Recovery Act of 2008, which established a new regulator for Fannie Mae and Freddie Mac and the establishment of the TALF and the PPIP. Some of these programs are beginning to expire and the impact of the wind-down of these programs on the financial sector and on the economic recovery is unknown.

The Federal Reserve initiated a program to purchase agency securities issued or guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae on January 5, 2009, and completed the purchase program in March 2010. The termination of the purchase program may cause a decrease in demand for agency securities, which could reduce their market price.

We have elected to participate in programs established by the U.S. government, including the TALF and the PPIP, in order to increase our ability to acquire our target assets and to provide a source of financing for such acquisitions. The TALF was intended to make credit available to consumers and businesses on more favorable terms by facilitating the issuance of asset-backed securities and improving the market conditions for asset-backed securities generally. The Federal Reserve Bank of New York, or FRBNY, made up to $200 billion of loans under the TALF. The facility will cease making loans collateralized by newly issued CMBS on June 30, 2010 and ceased making loans collateralized by newly issued asset-backed securities backed by consumer and business loans and legacy CMBS on March 31, 2010. As a result, we are no longer able to obtain additional TALF loans as a source of financing for investments in legacy CMBS.

The PPIP is designed to encourage the transfer of certain illiquid legacy real estate-related assets off of the balance sheets of financial institutions, restarting the market for these assets and supporting the flow of credit and other capital into the broader economy. As of March 31, 2010, the Invesco PPIP Fund no longer accepts investment subscriptions and the fund is now deemed closed.

Investment Activities

As of March 31, 2010, 26.4% of our equity was invested in Agency RMBS, 56.9% in non-Agency RMBS, 12.3% in CMBS, 7.7% in the Invesco PPIP Fund. We use leverage on our target assets to achieve our return objectives. For our investments in Agency RMBS, we focus on securities we believe provide attractive returns when levered approximately 6 to 8 times. For our investments in non-Agency RMBS, we invest in securities that provide attractive returns leveraged 1 to 2 times.

As of March 31, 2010, we had approximately $365.6 million in 30-year fixed rate securities that offered higher coupons and call protection based on the collateral attributes. We balanced this with approximately $307.5 million in 15-year fixed rate, approximately $134.4 million in hybrid adjustable-rate mortgages (“ARMs”) and approximately $9.3 million in ARMs we believe to have similar durations based on prepayment speeds. As of March 31, 2010, we had purchased approximately $379.3 million non-Agency RMBS.

Our investments in CMBS are securities for which we were able to obtain financing under the TALF. We have also financed, and may do so again in the future, our investments in CMBS through repurchase agreements and private financing sources. Our primary focus is on investing in AAA-rated securities issued prior to 2008. As of March 31, 2010, we had purchased approximately $215.0 million in CMBS and financed such purchases with a $151.8 million TALF loan and $18.1 million under repurchase agreements. In addition, as of March 31, 2010, we had purchased approximately $24.7 million in CMOs.

Investment Portfolio

The following table summarizes certain characteristics of our investment portfolio as of March 31, 2010:

$ in thousands	Principal Balance	Unamortized Premium (Discount)	Amortized Cost	Unrealized Gain/ (Loss)	Fair Value	Net Weighted Average Coupon (1)	Average Yield (2)
Agency RMBS:							
15 year fixed-rate	292,729	11,512	304,241	3,276	307,517	4.86 %	3.54 %
30 year fixed-rate	342,080	22,672	364,752	870	365,622	5.90 %	3.94 %
ARM	9,377	208	9,585	(257)	9,328	3.08 %	2.53 %
Hybrid ARM	128,763	6,027	134,790	(353)	134,437	4.98 %	2.78 %
Total Agency	772,949	40,419	813,368	3,536	816,904	5.32 %	3.58 %
MBS-CMO	23,411	739	24,150	575	24,725	6.33 %	4.88 %
Non-Agency MBS	613,798	(241,270)	372,528	6,804	379,332	3.80 %	11.58 %
CMBS	209,512	(1,861)	207,651	7,393	215,044	5.07 %	5.27 %
Total	1,619,670	(201,973)	1,417,697	18,308	1,436,005	4.72 %	5.95 %

(1) Net weighted average coupon is presented net of servicing and other fees.
(2) Average yield incorporates future prepayment assumptions.

The following table summarizes certain characteristics of our investment portfolio, at fair value, according to their estimated weighted average life classifications as of March 31, 2010:

$ in thousands	March 31, 2010
Less than one year	1,382
Greater than one year and less than five years	813,500
Greater than or equal to five years	621,123
Total	1,436,005

The following table presents certain information about the carrying value of our available for sale MBS at March 31, 2010:

$ in thousands	March 31, 2010
Principal balance	1,619,670
Unamortized premium	43,549
Unamortized discount	(245,522)
Gross unrealized gains	28,133
Gross unrealized losses	(9,825)
Carrying value/estimated fair value	1,436,005

Financing and Other Liabilities. We enter into repurchase agreements to finance the majority of our Agency RMBS, Non-Agency RMBS and some CMBS. These agreements are secured by our Agency RMBS, Non-Agency RMBS and CMBS and bear interest at rates that have historically moved in close relationship to the London Interbank Offer Rate (“LIBOR”). As of March 31, 2010, we had entered into repurchase agreements totaling $961.2 million. In addition, we funded most of our CMBS portfolio with borrowings of $151.8 million under the TALF. The TALF loans are non-recourse and mature in February 2013, July 2014, August 2014, December 2014 and January 2015. Finally, we committed to invest up to $100.0 million in the Invesco PPIP fund, which, in turn, invests in our target assets. As of March 31, 2010, $28.4 million of our commitment to the Invesco Fund has been called.

Hedging Instruments. We generally hedge as much of our interest rate risk as we deem prudent in light of market conditions. No assurance can be given that our hedging activities will have the desired beneficial impact on our results of operations or financial condition. Our investment policies do not contain specific requirements as to the percentages or amount of interest rate risk that we are required to hedge.

Interest rate hedging may fail to protect or could adversely affect us because, among other things:

- available interest rate hedging may not correspond directly with the interest rate risk for which protection is sought;
- the duration of the hedge may not match the duration of the related liability;
- the party owing money in the hedging transaction may default on its obligation to pay;
- the credit quality of the party owing money on the hedge may be downgraded to such an extent that it impairs our ability to sell or assign our side of the hedging transaction; and
- the value of derivatives used for hedging may be adjusted from time to time in accordance with accounting rules to reflect changes in fair value. Downward adjustments ("mark-to-market losses") would reduce our shareholders' equity.

As of March 31, 2010, we have entered into interest rate swap agreements designed to mitigate the effects of increases in interest rates under a portion of our repurchase agreements. These swap agreements provide for fixed interest rates indexed off of one-month LIBOR and effectively fix the floating interest rates on $675.0 million of borrowings under our repurchase agreements as of March 31, 2010. We intend to continue to add interest rate hedge positions according to our hedging strategy.

The following table summarizes our hedging activity as of March 31, 2010:

Counterparty	Notional Amount $ - in thousands	Maturity Date	Fixed Interest Rate in Contract	
The Bank of New York Mellon	175,000	8/5/2012	2.07	%
SunTrust Bank	100,000	7/15/2014	2.79	%
Credit Suisse International	100,000	2/24/2015	3.26	%
Credit Suisse International	100,000	3/24/2015	2.76	%
The Bank of New York Mellon	100,000	5/24/2013	1.83	%
Wells Fargo Bank, N.A.	100,000	7/15/2015	2.85	%
Total/Weighted Average	675,000		2.54	%

Book Value per Share

Our book value was $20.26 and $20.39 as of March 31, 2010 and December 31, 2009, respectively, on a fully diluted basis after giving effect to our units of limited partnership interest in our operating partnership, which may be converted to common shares at the sole election of the Company.

Critical Accounting Policies

Our consolidated financial statements are prepared in accordance with US GAAP, which requires the use of estimates and assumptions that involve the exercise of judgment and use of assumptions as to future uncertainties. Our most critical accounting policies involve decisions and assessments that could affect our reported assets and liabilities, as well as our reported revenues and expenses. We believe that all of the decisions and assessments upon which our consolidated financial statements are based are reasonable at the time made and based upon information available to us at that time. We rely upon independent pricing of our assets at each quarter's end to arrive at what we believe to be reasonable estimates of fair market value. The complete listing of our Critical Accounting Policies was disclosed in our 2009 annual report on Form 10-K, as filed with the SEC on March 24, 2010, as amended, and there have been no material changes to our Critical Accounting Policies as disclosed therein.

Results of Operations

The table below presents certain information from our Consolidated Statement of Operations for the three month periods ending March 31, 2010 and March 31, 2009:

$ in thousands, except per share data	For the Three Months Ended March 31, 2010 (unaudited)	March 31, 2009
Revenues		
Interest income	18,010	—
Interest expense	3,652	—
Net interest income	14,358	—
Other income (loss)		
Gain on sale of investments	733	—
Equity in earnings and fair value change in unconsolidated limited partnerships	446	—
Loss on other-than-temporarily impaired securities	(124)	—
Unrealized loss on interest rate swaps	(25)	—
Total other income	1,030	—
Expenses		
Management fee – related party	1,284	—
General and administrative	182	45
Insurance	346	—
Professional Fees	409	3
Total expenses	2,221	48
Net income (loss)	13,167	(48)
Net income loss attributable to non-controlling interest	1,118	—
Net income attributable to common shareholders	12,049	(48)
Earnings per share:		
Net income attributable to (basic/diluted)	0.77	NM
Dividends declared per common share	0.78	—
Weighted average number of shares of common stock:		
Basic	15,685	NM
Diluted	17,111	NM

NM = not meaningful

Net Income Summary

For the three months ended March 31, 2010, our net income was $13.2 million or $0.77 basic income per weighted average share available to common shareholders compared to $10.5 million or $1.02 basic income per weighted average share available to common shareholders for the three months ended December 31, 2009. The increase to net income is primarily attributable to the growth in our income portfolio resulting from our follow-on public offering in January 2010.

Interest Income and Average Earning Asset Yield

Our primary source of income is interest earned on our portfolio of mortgage-backed securities. We had average earning assets of $1.2 billion and $861.9 million and earned interest income of $18.0 million and $12.6 million for the three months ended March 31, 2010 and three months ended December 31, 2009, respectively. The yield on our average investment portfolio was 5.88% and 5.82% for the respective periods. The change in our average assets and the portfolio yield was primarily the result of the increase in our investment portfolio after our January follow-on common stock offering.

The constant prepayment rate ("CPR") of our portfolio impacts the amount of premium and discount on the purchase of securities that is recognized into income. Our agency and non-agency RMBS had a weighted average CPR of 12.7 and 15.7 for the 3 months ended March 31, 2010 and December 31, 2009, respectively. The table below shows the three month CPR for our MBS compared to bonds with similar characteristics ("Cohorts"):

	March 31, 2010		December 31, 2009	
	Company	Cohort	Company	Cohort
15 year Agency RMBS	10.7	19.5	15.0	21.8
30 year Agency RMBS	14.8	38.2	22.7	27.3
Agency Hybrid ARM RMBS	23.7	N/A	19.5	N/A
Non-Agency RMBS	15.0	N/A	16.0	N/A
Overall	12.7	N/A	15.7	N/A

On February 10, 2010, Fannie Mae and Freddie Mac announced their intention to purchase delinquent loans from certain mortgage pools guaranteed by them. For purposes of these purchases, delinquent loans are those that are 120 days or greater delinquent as of the measurement date. Freddie Mac stated that it would purchase substantially all of the delinquent loans. Fannie Mae purchased 220,000 delinquent loans in March 2010 and expects to purchase a significant portion of their current delinquent population within a few months, subject to market, servicer capacity and other constraints. The impact of the increased buy-outs would accelerate the amortization of premium paid for these agency RMBS, which would reduce our interest income. In the fourth quarter of 2009, the Company correctly anticipated the increased buy-outs and sold several agency RMBS that were at risk. For the three month period ended March 31, 2010, the Company's estimates the increased buy-outs reduced interest income by less than $1.0 million as a result of higher premium amortization. For the agency RMBS held in the portfolio as of March 31, 2010, the Company estimates that the completion of this buy-out program will have no significant effect on future periods.

Interest Expense and the Cost of Funds

Our largest expense is the interest expense on borrowed funds. We had average borrowed funds of $826.3 million and $666.2 million and total interest expense of $3.7 million and $2.6 million for the three months ended March 31, 2010 and three months ended December 31, 2009, respectively. The increase in average borrowed funds and interest expense was primarily the result of increasing our investment portfolio with the proceeds of our January 2010 follow-on public offering.

Our average cost of funds was 1.60% and 1.54% for the three months ended March 31, 2010 and three months ended December 31, 2009, respectively. Since a substantial portion of our repurchase agreements are short term, changes in market rates are directly reflected in our interest expense. Interest expense includes borrowing costs under repurchase agreements, the TALF borrowing, as well as any hedging costs for our cash flow hedges.

Net Interest Income

Our net interest income, which equals interest income less interest expense, totaled $14.3 million and $10.0 million for the three months ended March 31, 2010 and three months ended December 31, 2009, respectively. Our net interest rate margin, which equals the yield on our average assets for the period less the average cost of funds for the period, was 4.28% and 4.28% for the three months ended March 31, 2010 and three months ended December 31, 2009, respectively. The increase in net interest income was primarily the result of increasing our investment portfolio with the proceeds of our January 2010 follow-on public offering.

Gain on Sale of Investments

As part of our credit process, all of our MBS are reviewed on a monthly basis to determine if they continue to meet our risk and return targets. This process involves looking at changing market assumptions and the impact those assumptions will have on the individual securities. During the fourth quarter of 2009 we anticipated the government sponsored entities ("GSEs") would accelerate the required buy out of delinquent loans in the agency RMBS. As a result of our change in market assumptions, we sold securities and recognized gains of approximately $733,000 and $2.0 million for the three month periods ended March 31, 2010 and December 31, 2009, respectively.

Loss on Other-Than Temporary Impaired Securities

During the three months ended March 31, 2010, the trustees of certain non-Agency RMBS notified us that due to the deterioration of the underlying collateral in these securitizations, a portion of the principal of these securities had no value. Accordingly, we recognized a $124,000 loss on other-than-temporarily impaired securities in the consolidated statement of operations for the three months ended March 31, 2010, which had been included in accumulated other comprehensive income. No loss on other-than-temporary impairment on investments was recorded for the three months ended December 31, 2009.

Equity in Earnings and Change in Fair Value of Unconsolidated Limited Partnerships

For the three months ended March 31, 2010 and three months ended December 31, 2009, we recognized equity in earnings of $230,000 and $63,000, respectively, and unrealized income on the change in fair value of our investment in the Invesco PPIP Fund of approximately $216,000 and $8,000, respectively. The increase in each case was primarily the result of our increased commitment from $25.0 million to $100.0 million and an increase in our capital contributed to the Invesco PPIP Fund.

Other Income (Loss)

Our other income (loss) relates to the unrealized loss on interest rate swaps of approximately $25,000, which represents the ineffective portion of the change in fair value of our interest rate swaps which is recognized directly in earnings for the three months ended March 31, 2010. No unrealized loss on interest rate swap ineffectiveness was recorded for the three months ended December 31, 2009.

Expenses

We incurred management fees of $1.3 million and $760,000 for the three months ended March 31, 2010, and three months ended December 31, 2009, respectively, which are payable to our Manager under our management agreement. The increase in management fees is attributed to an increase in shareholders' equity resulting from our follow-on public offering in January 2010. This management fee and the relationship between the Company and the Manager are discussed further in our discussion of related party relationships.

Our general and administrative expense of $182,000 and $150,000 for the three ended March 31, 2010 and three months ended December 31, 2009, respectively, includes the salary and the estimated bonus of our CFO, amortization of equity based compensation related to anticipated quarterly grants of our stock to the Company's independent directors, payable subsequent to each calendar quarter, amortization of equity based compensation related to restricted stock grants to our executive officers who are employees of the Manager, cash based payments to our Company's independent directors, derivative transaction fees, software licensing, industry memberships, filing fees, travel and entertainment and other miscellaneous general and administrative costs. The increase in general and administrative expenses between the three months ended March 31, 2010 and three month ended December 31, 2009 is primarily attributable to an increase in salary and estimated bonus of our CFO.

Our insurance expense of $346,000 and $354,000 for the three months ended March 31, 2010 and three months ended December 31, 2009, respectively, represents the cost of liability insurance to indemnify our directors and officers.

Our professional fees of $409,000 and $341,000 for the three months ended March 31, 2010 and the three months ended December 31, 2009, respectively, represents the cost of legal, accounting, auditing and consulting services provided to us by third party service providers. The increase in professional fees between the three months ended March 31, 2010 and three months ended December 31, 2009 is primarily attributable to an increase in accounting and legal costs.

Net Income and Return on Average Equity

Our net income was $13.2 million and $10.5 million for the three months ended March 31, 2010 and the three months ended December 31, 2009, respectively. Our annualized return on average equity was 15.68% and 19.35% for the three months ended March 31, 2010 and three months ended December 31, 2009, respectively. The increase in net income was primarily the result of increasing our investment portfolio with the proceeds of our January 2010 public offering. The decrease in return on average equity is primarily a result of greater average shares outstanding resulting from our January 2010 public offering and a lower gain on sale of investments between the two periods.

Liquidity and Capital Resources

Liquidity is a measurement of our ability to meet potential cash requirements, including ongoing commitments to pay dividends, fund investments and other general business needs. Our primary sources of funds for liquidity consists of the net proceeds from our common equity offerings, net cash provided by operating activities, cash from repurchase agreements and other financing arrangements and future issuances of equity and/or debt securities. We also have financed, and may continue to finance our assets under, and may otherwise participate in, programs established by the U.S. government.

We currently believe that we have sufficient liquidity and capital resources available for the acquisition of additional investments, repayments on borrowings and the payment of cash dividends as required for continued qualification as a REIT. We generally maintain liquidity to pay down borrowings under repurchase arrangements to reduce borrowing costs and otherwise efficiently manage our long-term investment capital. Because the level of these borrowings can be adjusted on a daily basis, the level of cash and cash equivalents carried on the balance sheet is significantly less important than our potential liquidity available under borrowing arrangements.

We allocate our equity to each of our target assets and apply leverage to obtain our net interest income. We invest in assets that provide attractive returns with an aggregate debt-to-equity ratio of 3 to 5 times. To obtain this total leverage we lever agency RMBS 6 to 8 times, non-agency RMBS 1 to 2 times and CMBS 3 to 4 times. The table below shows the allocation of our equity and debt-to-equity ratio as of March 31, 2010.

$ in thousands	Agency	Non-Agency	CMBS	PPIF	Total
Borrowings	773,490	169,534	169,958	—	1,112,982
Equity allocation	98,459	211,496	45,695	16,326	371,976
Debt / Equity Ratio	7.9	0.8	3.7	—	3.0
% of Total Equity	26.4 %	56.9 %	12.3 %	4.4 %	100.0 %

We enter into repurchase agreements with various counterparties to fund our purchase of MBS. The following table summarizes our total borrowings by type of investment for the period ended March 31, 2010 and December 31, 2009:

$ in thousands	March 31, 2010		December 31, 2009	
Repurchase Agreements	Amount Outstanding	Weighted Average	Amount Outstanding	Weighted Average
Agency RMBS	773,490	0.24 %	545,975	0.26 %
Non-Agency RBS	169,534	1.49 %	—	—
CMBS	18,139	1.05 %	—	—
Total Repurchase agreements	961,163	0.47 %	545,975	0.26 %

CMBS under TALF	151,819	3.56	%	80,377	3.82	%
Total Borrowings	1,112,982	0.90	%	626,352	0.72	%

As of March 31, 2010, the weighted average margin requirement, or the percentage amount by which the collateral value must exceed the loan amount, which we also refer to as the "haircut," under our repurchase agreements for Agency RMBS was approximately 5.0% (weighted by borrowing amount) and under our repurchase agreements for Non-Agency RMBS was approximately 29.7%. Across our repurchase facilities for Agency RMBS, the haircuts range from a low of 3% to a high of 8% and for Non-Agency RMBS range from a low of 12% to a high of 50%. Declines in the value of our securities portfolio can trigger margin calls by our lenders under our repurchase agreements. An event of default or termination event would give some of our counterparties the option to terminate all repurchase transactions existing with us and require any amount due by us to the counterparties to be payable immediately.

As discussed above under "Market Conditions," the residential mortgage market in the United States has experienced difficult economic conditions including:

- increased volatility of many financial assets, including agency securities and other high-quality RMBS assets, due to news of potential security liquidations;
- increased volatility and deterioration in the broader residential mortgage and RMBS markets; and
- significant disruption in financing of RMBS.

If these conditions persist, then our lenders may be forced to exit the repurchase market, become insolvent or further tighten lending standards or increase the amount of required equity capital or haircut, any of which could make it more difficult or costly for us to obtain financing.

Effects of Margin Requirements, Leverage and Credit Spreads

Our securities have values that fluctuate according to market conditions and, as discussed above, the market value of our securities will decrease as prevailing interest rates or credit spreads increase. When the value of the securities pledged to secure a repurchase loan decreases to the point where the positive difference between the collateral value and the loan amount is less than the haircut, our lenders may issue a "margin call," which means that the lender will require us to pay the margin call in cash or pledge additional collateral to meet that margin call. Under our repurchase facilities, our lenders have full discretion to determine the value of the securities we pledge to them. Most of our lenders will value securities based on recent trades in the market. Lenders also issue margin calls as the published current principal balance factors change on the pool of mortgages underlying the securities pledged as collateral when scheduled and unscheduled paydowns are announced monthly.

We experience margin calls in the ordinary course of our business. In seeking to effectively manage the margin requirements established by our lenders, we maintain a position of cash and unpledged securities. We refer to this position as our "liquidity." The level of liquidity we have available to meet margin calls is directly affected by our leverage levels, our haircuts and the price changes on our securities. If interest rates increase as a result of a yield curve shift or for another reason or if credit spreads widen, then the prices of our collateral (and our unpledged assets that constitute our liquidity) will decline, we will experience margin calls, and we will use our liquidity to meet the margin calls. There can be no assurance that we will maintain sufficient levels of liquidity to meet any margin calls. If our haircuts increase, our liquidity will proportionately decrease. In addition, if we increase our borrowings, our liquidity will decrease by the amount of additional haircut on the increased level of indebtedness.

We intend to maintain a level of liquidity in relation to our assets that enables us to meet reasonably anticipated margin calls but that also allows us to be substantially invested in securities. We may misjudge the appropriate amount of our liquidity by maintaining excessive liquidity, which would lower our investment returns, or by maintaining insufficient liquidity, which would force us to liquidate assets into unfavorable market conditions and harm our results of operations and financial condition.

Forward-Looking Statements Regarding Liquidity

Based upon our current portfolio, leverage rate and available borrowing arrangements, we believe that the net proceeds of our common equity offerings and private placements, combined with cash flow from operations and available borrowing capacity, will be sufficient to enable us to meet anticipated short-term (one year or less) liquidity requirements to fund our investment activities, pay fees under our management agreement, fund our distributions to shareholders and for other general corporate expenses.

Our ability to meet our long-term (greater than one year) liquidity and capital resource requirements will be subject to obtaining additional debt financing and equity capital. We may increase our capital resources by obtaining long-term credit facilities or making public or private offerings of equity or debt securities, possibly including classes of preferred stock, common stock, and senior or subordinated notes. Such financing will depend on market conditions for capital raises and for the investment of any proceeds. If we are unable to renew, replace or expand our sources of financing on substantially similar terms, it may have an adverse effect on our business and results of operations.

Contractual Obligations

On July 1, 2009, we entered into an agreement with our Manager pursuant to which our Manager is entitled to receive a management fee and the reimbursement of certain expenses. The management fee will be calculated and payable quarterly in arrears in an amount equal to 1.50% of our shareholders' equity, per annum, calculated and payable quarterly in arrears. Our Manager will use the proceeds from its management fee in part to pay compensation to its officers and personnel who, notwithstanding that certain of those individuals are also our officers, will receive no cash compensation directly from us. We are required to reimburse our Manager for operating expenses related to us incurred by our Manager, including certain salary expenses and other expenses relating to legal, accounting, due diligence and other services. Expense reimbursements to our Manager are made in cash on a monthly basis following the end of each month. Our reimbursement obligation is not subject to any dollar limitation.

Contractual Commitments

As of March 31, 2010, we had the following contractual commitments and commercial obligations:

	Payments Due by Period				
$ in thousands	Total	Less than 1 year	1-3 years	3-5 years	After 5 years
Repurchase agreements	961,163	961,163	—	—	—
TALF financing	151,819	—	—	151,819	—
Invesco PPIP Fund investment	71,572	—	71,572	—	—
Total contractual obligations	1,184,554	961,163	71,572	151,819	—

As of March 31, 2010 we have approximately $177,000 and $24.4 million in contractual interest payments related to our repurchase agreements and TALF financings respectively.

Off-Balance Sheet Arrangements

We committed to invest up to $100.0 million in the Invesco PPIP Fund, which, in turn, invests in our target assets. As of March 31, 2010, approximately $28.4 million of the commitment has been called.

Shareholders' Equity

On January 15, 2010, we completed a follow-on public offering of 7,000,000 shares of common stock and an issuance of an additional 1,050,000 shares of common stock pursuant to the underwriters' full exercise of their over-allotment option at $21.25 per share. The net proceeds to us were $162.6 million, net of issuance costs of approximately $8.5 million.

Unrealized Gains and Losses

Unrealized fluctuations in market values of assets do not impact our US GAAP income but rather are reflected on our balance sheet by changing the carrying value of the asset and shareholders' equity under "Accumulated Other

Comprehensive Income (Loss)," we account for our investment securities as "available-for-sale." In addition, unrealized fluctuations in market values of our cash flow hedges that qualify for hedge accounting are also reflected in "Accumulated Other Comprehensive Income (Loss)."

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.

Dividends

We intend to continue to make regular quarterly distributions to holders of our common stock. U.S. federal income tax law generally requires that a REIT distribute annually at least 90% of its REIT taxable income, determined without regard to the deduction for dividends paid and excluding net capital gains, and that it pay tax at regular corporate rates to the extent that it annually distributes less than 100% of its net taxable income. We intend to pay regular quarterly dividends to our shareholders in an amount equal at least 90% of our net taxable income. Before we pay any dividend, whether for U.S. federal income tax purposes or otherwise, we must first meet both our operating requirements and debt service on our repurchase agreements and other debt payable. If our cash available for distribution is less than our net taxable income, we could be required to sell assets or borrow funds to make cash distributions, or we may make a portion of the required distribution in the form of a taxable stock distribution or distribution of debt securities.

On March 17, 2010, the Company declared a dividend of $0.78 per share of common stock. The dividend was paid on April 22, 2010 to shareholders of record as of the close of business on March 31, 2010.

Inflation

Virtually all of our assets and liabilities are interest rate sensitive in nature. As a result, interest rates and other factors influence our performance far more than inflation. Changes in interest rates do not necessarily correlate with inflation rates or changes in inflation rates.

Other Matters

We calculate that at least 75% of our assets were qualified REIT assets, as defined in the Internal Revenue Code of 1986, as amended (the "Code") for the quarter ended March 31, 2010. 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 quarter ended March 31, 2010. Consequently, we met the REIT income and asset test as of March 31, 2010. We also met all REIT requirements regarding the ownership of our common stock and the distribution of our net income as of March 31, 2010. Therefore, as of March 31, 2010, 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 required to register as an investment company under the 1940 Act. If we were to become required to register as an investment company, then our use of leverage would be substantially reduced. Because we are a holding company that conducts our business through the operating partnership and the wholly-owned or majority owned subsidiaries of the operating partnership, the securities issued by these subsidiaries that are excepted from the definition of "investment company" under Section 3(c)(1) or Section 3(c)(7) of the 1940 Act, together with any other investment securities the operating partnership may own, may not have a combined value in excess of 40% of the value of the operating partnership's total assets (exclusive of U.S. government securities and cash) on an unconsolidated basis, which we refer to as the 40% test. This requirement limits the types of businesses in which we may engage through our subsidiaries. In addition, we believe neither the company nor the operating partnership are considered an investment company under Section 3(a)(1)(A) of the 1940 Act because they do not engage primarily or hold themselves out as being engaged primarily in the business of investing, reinvesting or trading in securities. Rather, through the operating partnership's wholly owned or majority-owned subsidiaries, the company and the operating partnership are primarily engaged in the non-investment company businesses of these subsidiaries. IAS Asset I LLC and certain of the operating partnership's other subsidiaries that we may form in the future rely upon the exclusion from the definition of "investment company" under the 1940 Act provided by Section 3(c)(5)(C) of the 1940 Act, which is available for entities "primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate." This exclusion generally requires that at least 55% of each of our subsidiaries' portfolios be comprised of qualifying assets and at least 80% of each of their portfolios be comprised of qualifying assets and real estate-related assets (and no more than 20% comprised of miscellaneous assets). Qualifying assets for this purpose include mortgage loans fully secured by real estate and other assets, such as whole pool Agency and non-Agency RMBS, that the Securities and Exchange Commission, or SEC, or its staff in various no-action letters has determined are the functional equivalent of mortgage loans fully secured by real estate. We treat as real estate-related assets CMBS, debt and equity securities of companies primarily engaged in real estate businesses, agency partial pool certificates and securities issued by pass-through entities of which substantially all of the assets consist of qualifying assets and/or real estate-related assets. Additionally, unless certain mortgage securities represent all the certificates issued with respect to an underlying pool of mortgages, the MBS 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, 2010, we were in compliance with this requirement.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

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

Interest Rate Risk

Interest rate risk is highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political considerations, and other factors beyond our control. We are subject to interest rate risk in connection with our investments and our repurchase agreements. Our repurchase agreements are typically of limited duration and will be periodically refinanced at current market rates. We mitigate this risk through utilization of derivative contracts, primarily interest rate swap agreements, interest rate caps and interest rate floors.

Interest Rate Effect on Net Interest Income

Our operating results depend in large part upon differences between the yields earned on our investments and our cost of borrowing and interest rate hedging activities. Most of our repurchase agreements provide financing based on a floating rate of interest calculated on a fixed spread over LIBOR. The fixed spread will vary depending on the type of underlying asset which collateralizes the financing. Accordingly, the portion of our portfolio which consists of floating interest rate assets are match-funded utilizing our expected sources of short-term financing, while our fixed interest rate assets are not match-funded. During periods of rising interest rates, the borrowing costs associated with our investments tend to increase while the income earned on our fixed interest rate investments may remain substantially unchanged. This increase in borrowing costs results in the narrowing of the net interest spread between the related assets and borrowings and may even result in losses. Further, during this portion of the interest rate and credit cycles, defaults could increase and result in credit losses to us, which could adversely affect our liquidity and operating results. Such delinquencies or defaults could also have an adverse effect on the spread between interest-earning assets and interest-bearing liabilities.

Hedging techniques are partly based on assumed levels of prepayments of our RMBS. If prepayments are slower or faster than assumed, the life of the RMBS will be longer or shorter, which would reduce the effectiveness of any hedging strategies we may use and may cause losses on such transactions. Hedging strategies involving the use of derivative securities are highly complex and may produce volatile returns.

Interest Rate Effects on Fair Value

Another component of interest rate risk is the effect that changes in interest rates will have on the market value of the assets that we acquire. We face the risk that the market value of our assets will increase or decrease at different rates than those of our liabilities, including our hedging instruments.

We primarily assess our interest rate risk by estimating the duration of our assets and the duration of our liabilities. Duration measures the market price volatility of financial instruments as interest rates change. We generally calculate duration using various financial models and empirical data. Different models and methodologies can produce different duration numbers for the same securities.

It is important to note that the impact of changing interest rates on fair value can change significantly when interest rates change materially. Therefore, the volatility in the fair value of our assets could increase significantly when interest rates change materially. In addition, other factors impact the fair value of our interest rate-sensitive investments and hedging instruments, such as the shape of the yield curve, market expectations as to future interest rate changes and other market conditions. Accordingly, changes in actual interest rates may have a material adverse effect on us.

Prepayment Risk

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

Extension Risk

We compute the projected weighted-average life of our investments based upon assumptions regarding the rate at which the borrowers will prepay the underlying mortgages. In general, when a fixed-rate or hybrid adjustable-rate security is acquired with borrowings, we may, but are not required to, enter into an interest rate swap agreement or other hedging instrument that effectively fixes our borrowing costs for a period close to the anticipated average life of the fixed-rate portion of the related assets. This strategy is designed to protect us from rising interest rates, because the borrowing costs are fixed for the duration of the fixed-rate portion of the related target asset.

However, if prepayment rates decrease in a rising interest rate environment, then the life of the fixed-rate portion of the related assets could extend beyond the term of the swap agreement or other hedging instrument. This could have a negative impact on our results from operations, as borrowing costs would no longer be fixed after the end of the hedging instrument, while the income earned on the hybrid adjustable-rate assets would remain fixed. This situation may also cause the market value of our hybrid adjustable-rate assets to decline, with little or no offsetting gain from the related hedging transactions. In extreme situations, we may be forced to sell assets to maintain adequate liquidity, which could cause us to incur losses.

Market Risk

Market Value Risk

Our available-for-sale securities are reflected at their estimated fair value with unrealized gains and losses excluded from earnings and reported in other comprehensive income pursuant to ASC Topic 320. The estimated fair value of these securities fluctuates primarily due to changes in interest rates and other factors. Generally, in a rising interest rate environment, the estimated fair value of these securities would be expected to decrease; conversely, in a decreasing interest rate environment, the estimated fair value of these securities would be expected to increase.

The sensitivity analysis table presented below shows the estimated impact of an instantaneous parallel shift in the yield curve, up and down 50 and 100 basis points, on the market value of our interest rate-sensitive investments and net interest income, at March 31, 2010, assuming a static portfolio. When evaluating the impact of changes in interest rates, prepayment assumptions and principal reinvestment rates are adjusted based on our Manager’s expectations. The analysis presented utilized assumptions, models and estimates of our Manager based on our Manager’s judgment and experience.

Change in Interest Rates	Percentage Change in Projected Net Interest Income	Percentage Change in Projected Portfolio Value
+1.00%	15.32%	(1.31)%
+0.50%	7.00%	(0.60)%
-0.50%	(6.98)%	0.37%

-1.00%	(15.04)%	0.41%

Real Estate Risk

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

Credit Risk

We believe that our investment strategy will generally keep our credit losses and financing costs low. However, we retain the risk of potential credit losses on all of the residential and commercial mortgage loans, as well as the loans underlying the Non-Agency RMBS and CMBS in our portfolio. We seek to manage this risk through our pre-acquisition due diligence process and through the use of non-recourse financing, which limits our exposure to credit losses to the specific pool of mortgages that are subject to the non-recourse financing. In addition, with respect to any particular asset, our Manager's investment team evaluates, among other things, relative valuation, supply and demand trends, shape of yield curves, prepayment rates, delinquency and default rates, recovery of various sectors and vintage of collateral.

Risk Management

To the extent consistent with maintaining our REIT qualification, we seek to manage risk exposure to protect our investment portfolio against the effects of major interest rate changes. We generally seek to manage this risk by:

- monitoring and adjusting, if necessary, the reset index and interest rate related to our target assets and our financings;

- attempting to structure our financing agreements to have a range of different maturities, terms, amortizations and interest rate adjustment periods;

- using hedging instruments, primarily interest rate swap agreements but also financial futures, options, interest rate cap agreements, floors and forward sales to adjust the interest rate sensitivity of our target assets and our borrowings; and

- actively managing, on an aggregate basis, the interest rate indices, interest rate adjustment periods, and gross reset margins of our target assets and the interest rate indices and adjustment periods of our financings.

ITEM 4T. CONTROLS AND PROCEDURES.

Our management is responsible for establishing and maintaining disclosure controls and procedures that are designed to ensure that information we are required to disclose in the reports that we file or submit under the Securities Exchange Act of 1934, as amended (the "Exchange Act") is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include controls and procedures designed to ensure that the required information is accumulated or communicated to our management, including our principal executive and principal financial officers, as appropriate, to allow timely decisions regarding required disclosure.

We have evaluated, with the participation of our principal executive officer and principal financial officer, the effectiveness of our disclosure controls and procedures as of March 31, 2010. 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. Based upon our evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the applicable rules and forms, and that it is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

No change occurred in our internal control over financial reporting (as defined in Rule13a-15(f) and 15d-15(f) of the Exchange Act) during the three months ended March 31, 2010 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II — OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

From time to time, we may be involved in various claims and legal actions arising in the ordinary course of business. As of March 31, 2010, we were not involved in any such legal proceedings.

ITEM 1A. RISK FACTORS.

There were no material changes during the period covered by this report to the risk factors previously disclosed in our annual report on Form 10-K filed on March 24, 2010.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

ITEM 4. RESERVED

ITEM 5. OTHER INFORMATION.

None.

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.

INVESCO MORTGAGE CAPITAL INC.

May 14, 2010	By:	/s/ Richard J. King Richard J. King President and Chief Executive Officer
May 14, 2010	By:	/s/ Donald R. Ramon Donald R. Ramon Chief Financial Officer

EXHIBIT INDEX

Item 6. Exhibits

Exhibit No.	Description
3.1	Articles of Amendment and Restatement of Invesco Mortgage Capital Inc., incorporated by reference to Exhibit 3.1 to our Quarterly Report on Form 10-Q, filed with the Securities and Exchange Commission on August 12, 2009.
3.2	Amended and Restated Bylaws of Invesco Mortgage Capital Inc., incorporated by reference to Exhibit 3.2 to Amendment No. 8 to our Registration Statement on Form S-11, filed with the Securities and Exchange Commission on June 18, 2009.
31.1	Certification of Richard J. King pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Donald R. Ramon pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Richard J. King pursuant to Rule 13a-14(b) and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Donald R. Ramon pursuant to Rule 13a-14(b) and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.