CONSTELLATION BRANDS, INC.
Form 424B2
August 07, 2012
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CALCULATION OF REGISTRATION FEE

Title of each class of securities to be registered	Aggregate offering price	Amount of registration fee(1)
Debt Securities and Guarantees thereof	$650,000,000	$74,490.00

(1) Calculated in accordance with Rule 457(r) if the Securities Act of 1933, as amended (the Securities Act).

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Filed Pursuant to Rule 424(b)(2)
Registration No. 333-179266

PROSPECTUS SUPPLEMENT

(To Prospectus Dated August 6, 2012)

$650,000,000

4.625% Senior Notes due 2023

The Company:

We are the world s leading premium wine company with a broad portfolio of consumer-preferred premium wine brands complemented by premium spirits, imported beer and other select beverage alcohol products.

The Offering:

Use of Proceeds: We intend to use the net proceeds from this offering of the Senior Notes due 2023, which we refer to as the notes, together with additional borrowings under our senior credit facility and available cash, to finance our pending acquisition of the 50% membership interest in Crown Imports LLC not already owned by us, which we refer to as the Crown Acquisition, or, if we are unable to finance the entire Crown Acquisition, towards the purchase of at least one-half of the 50% membership interest we do not already own, which we refer to as the Alternate Crown Acquisition. The facilities under our senior credit agreement, as amended, refinanced, extended, substituted, replaced or renewed from time to time, are referred to collectively as our senior credit facility.

The Notes:

Issuer: Constellation Brands, Inc.

Maturity: The notes will mature on March 1, 2023.

Interest Payments: The notes will pay interest semi-annually in cash in arrears on March 1 and September 1 of each year, commencing March 1, 2013.

Guarantees: Certain of our existing and future subsidiaries will guarantee the notes on a senior unsecured basis to the extent and for so long as such entities guarantee our senior credit facility.

Ranking: The notes will rank equally in right of payment with all of our existing and future unsecured senior indebtedness, senior in right of payment to any indebtedness that is expressly subordinated to the notes, and effectively subordinated in right of payment to our secured indebtedness to the extent of the value of the assets securing such indebtedness, including all borrowings under our senior credit facility.

Optional Redemption: The notes may be redeemed, in whole or in part at a price equal to 100% of the principal amount thereof, together with accrued and unpaid interest to the redemption date, plus a make-whole premium.

Escrow Arrangement/Special Mandatory Redemption: An amount equal to the aggregate public offering price of the notes will be placed in an escrow account. The escrowed funds will be released to fund a portion of the Crown Acquisition or the Alternate Crown Acquisition. If, however, the Membership Interest Purchase Agreement relating to the Crown Acquisition is terminated and the transactions contemplated thereby are abandoned or if neither the Crown Acquisition nor the Alternate Crown Acquisition has been consummated on or prior to December 30, 2013, all of the notes will be redeemed at a price equal to 100% of the aggregate public offering price thereof, together with accrued and unpaid interest (and, if applicable, the accreted portion of any original issue discount) to the date of the special mandatory redemption. We will not prefund interest or original issue discount that may accrete on the notes into the escrow account.

Change of Control: If we experience specific kinds of changes of control, we must offer to repurchase all of the notes at 101% of their principal amount, plus accrued and unpaid interest, if any, to the repurchase date.

This investment involves risks. See Risk Factors beginning on page S-11.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of the notes or determined if this prospectus supplement or the accompanying prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

	Per Senior Note	Total
Public Offering Price (1)	100.00%	$650,000,000
Underwriting Discount	1.25%	$ 8,125,000
Proceeds to Constellation Brands (before expenses)	98.75%	$641,875,000

(1) Plus accrued interest from August 14, 2012.

The notes will be ready for delivery in book-entry form only through The Depository Trust Company on or about August 14, 2012.

Joint Book Running Managers

BofA Merrill Lynch

J.P. Morgan

Rabo Securities

Barclays

Wells Fargo Securities

Co-Managers

HSBC **Mitsubishi UFJ Securities**

August 6, 2012

You should rely only on the information contained or incorporated by reference in this prospectus supplement, the accompanying prospectus or documents to which we otherwise refer you. We have not, and the underwriters have not, authorized anyone to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. We are not, and the underwriters are not, making an offer to sell these securities in any jurisdiction where the offer or sale is not permitted. You should not assume that the information appearing in this prospectus supplement, the accompanying prospectus and any document incorporated by reference is accurate as of any date other than the date on the front cover of the applicable document. Our business, financial condition, results of operations and prospects may have changed since that date.

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Prospectus Supplement

Prospectus

Unless otherwise indicated or the context requires otherwise, references to we, us, our and the Company refer collectively to Constellation Brands, Inc. and its subsidiaries except that in the sections entitled Prospectus Supplement Summary The Offering and Description of the Notes and the Guarantees such terms refer only to Constellation Brands, Inc. and not any of its subsidiaries.

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WHERE YOU CAN FIND MORE INFORMATION

We file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission, or the SEC. You may read and copy any document we file with the SEC at the SEC s Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. You may obtain further information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. Our SEC filings are also available to the public over the Internet at the SEC s website at http://www.sec.gov. Our class A and class B common stock are listed on the New York Stock Exchange, and you may inspect our SEC filings at the offices of the New York Stock Exchange, 20 Broad Street, New York, New York 10005.

The SEC allows us to incorporate by reference into this prospectus supplement the information we file with the SEC, which means that we can disclose important information to you by referring you to previously filed documents. The information incorporated by reference is considered to be part of this prospectus supplement, unless we update or supersede that information by the information contained in this prospectus supplement or by information that we file subsequently that is incorporated by reference into this prospectus supplement.

We incorporate by reference into this prospectus supplement the following documents or information filed with the SEC (other than, in each case, documents or information deemed to have been furnished and not filed in accordance with SEC rules):

Annual Report on Form 10-K for the fiscal year ended February 29, 2012 filed on April 30, 2012;

Quarterly Report on Form 10-Q for the fiscal quarter ended May 31, 2012 filed on July 10, 2012;

Current Reports on Form 8-K filed on April 5, 2012 (of the two reports filed on that date, only the one reporting information under Items 5.02 and 9.01); April 16, 2012; April 23, 2012; May 9, 2012; July 2, 2012 (Items 1.01, 2.03 and 9.01 only (but excluding Exhibit 99.1)); and July 31, 2012;

The description of our class A common stock, par value $.01 per share, and class B common stock, par value $.01 per share, contained in Item 1 of our registration statement on Form 8-A filed on October 4, 1999; and

All documents filed by the Company under Sections 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934, as amended, on or after the date of this prospectus supplement and before the termination of this offering.

This prospectus supplement and the accompanying prospectus are part of a registration statement we have filed with the SEC relating to the notes offered by this prospectus supplement and other securities. As permitted by SEC rules, this prospectus supplement and the accompanying prospectus do not contain all of the information included in the registration statement and the accompanying exhibits and schedules we file with the SEC. You may refer to the registration statement, the exhibits and schedules for more information about us and our debt securities. The registration statement, exhibits and schedules are also available at the SEC s Public Reference Room or through its website. In addition, we post the periodic reports that we file with the SEC on our website at http://www.cbrands.com. You may also obtain a copy of these filings, at no cost, by writing to or telephoning us at the following address:

Constellation Brands, Inc.

207 High Point Drive, Building 100

Victor, New York 14564

585-678-7100

Attention: David S. Sorce, Secretary

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus supplement, the accompanying prospectus and the documents incorporated or deemed to be incorporated by reference herein contain forward-looking statements that involve risks and uncertainties, including those discussed under the caption Risk Factors. We develop forward-looking statements by combining currently available information with our beliefs and assumptions. These statements relate to future events, including our future performance, and often contain words such as may, should, could, expects, seeks to, anticipates, plans, b estimates, intends, predicts, projects, potential or continue or the negative of such terms and other comparable terminology. Forward-look statements are inherently uncertain, and actual performance or results may differ materially and adversely from that expressed in, or implied by, any such statements. Consequently, you should recognize these statements for what they are and we caution you not to rely upon them as facts.

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PROSPECTUS SUPPLEMENT SUMMARY

This summary highlights selected information about the Company and this offering. It does not contain all of the information that may be important to you in deciding whether to purchase notes. We encourage you to read the entire prospectus supplement, the accompanying prospectus and the documents that we have filed with the SEC that are incorporated by reference prior to deciding whether to purchase notes.

Constellation Brands, Inc.

We are the world s leading premium wine company with a leading market position in both of our primary markets, which are the United States (U.S.) and Canada. Our wine portfolio is complemented by select premium spirits brands and other select beverage alcohol products. We are also the leading marketer of imported beer in the U.S. through our investment in Crown Imports LLC, which we refer to below as Crown, a 50/50 joint venture with Grupo Modelo, S.A.B. de C.V., pursuant to which Grupo Modelo s Mexican beer portfolio is imported, marketed and sold by Crown in the U.S. As described below under Recent Developments The Crown Acquisition, we signed a definitive agreement to acquire the remaining equity interest in Crown not already owned by us for approximately $1.85 billion.

Since our founding in 1945 as a producer and marketer of wine products, we have grown through a combination of internal growth and acquisitions. Our internal growth has been driven by leveraging our existing portfolio of leading brands, developing new products, new packaging and line extensions, and focusing on the faster growing sectors of the beverage alcohol industry. We conduct our business through entities we wholly own as well as a variety of joint ventures with various other entities, both within and outside the U.S.

Corporate Information

Our principal executive offices are located at 207 High Point Drive, Building 100, Victor, New York 14564 and our telephone number is 585-678-7100. We maintain a website at www.cbrands.com. Our website and the information contained on that site, or connected to that site, are not incorporated into this prospectus, and you should not rely on any such information in making your decision whether to purchase the notes. We are a Delaware corporation that was incorporated on December 4, 1972, as the successor to a business founded in 1945. On September 19, 2000, we changed our name to Constellation Brands, Inc. from Canandaigua Brands, Inc.

Recent Developments

The Crown Acquisition

On June 28, 2012, we entered into a Membership Interest Purchase Agreement, which we refer to as the Membership Interest Purchase Agreement, to acquire the 50% equity interest in Crown not already owned by us, which we refer to as the Crown Acquisition. The consummation of the Crown Acquisition is conditioned on the consummation of the acquisition of Grupo Modelo by Anheuser-Busch InBev. Crown has the exclusive right to import, market and sell primarily Grupo Modelo s Mexican beer portfolio in the 50 states of the U.S., the District of Columbia and Guam. The Crown portfolio of brands includes Corona Extra, the best-selling imported beer and the sixth best-selling beer overall in the industry; Corona Light, the leading imported light beer; and Modelo Especial, the third largest and one of the fastest growing major imported beer brands. The pending acquisition of Crown will position the Company as the largest multi-category supplier of beverage alcohol in the U.S.

We currently expect to complete the Crown Acquisition, subject to satisfaction of limited closing conditions, in the first quarter of calendar 2013. We cannot guarantee, however, that the Crown Acquisition will be completed upon the agreed upon terms, or at all.

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If we are unable to obtain financing sufficient to enable us to pay the purchase price for the entire 50% membership interest in Crown not already owned by us, then pursuant to the terms of the Membership Interest Purchase Agreement, we must purchase at least one-half of such 50% membership interest (the Alternate Crown Acquisition) for a pro-rated purchase price plus a fee of $150.0 million payable to the seller.

An amount equal to the aggregate public offering price of the notes will be placed in an escrow account, which account will be pledged to the trustee for the benefit of the holders of the notes for so long as the proceeds remain in escrow. The escrowed funds will be used to fund a portion of the Crown Acquisition or the Alternate Crown Acquisition. If, however, the Membership Interest Purchase Agreement is terminated and the transactions contemplated thereby are abandoned or if neither the Crown Acquisition nor the Alternate Crown Acquisition has been consummated on or prior to December 30, 2013, we will be required to redeem all of the notes at a redemption price equal to 100% of their aggregate public offering price, plus accrued and unpaid interest (and, if applicable, the accreted portion of any original issue discount) to the date of the special mandatory redemption. See Description of the Notes and the Guarantees Escrow of Proceeds; Release Conditions and Description of the Notes and the Guarantees Special Mandatory Redemption.

Financing Arrangements for the Crown Acquisition

We expect the sources of permanent financing for the Crown Acquisition to consist of:

- the proceeds from the sale of the notes in this offering;
- a $575.0 million incremental term loan under our senior credit facility; and
- borrowings under our revolving facility under our senior credit facility and/or cash on hand (however, as adjusted information in this prospectus supplement assumes a $650.0 million borrowing under our revolving facility).

We are currently pursuing an amendment and restatement of our senior credit facility to establish a committed $575.0 million delayed draw incremental term loan facility maturing in 2017 and amortizing in annual amounts of 5% to 10% prior to maturity to fund a portion of the Crown Acquisition. The terms of an amendment and restatement of our senior credit facility have not been finalized. Accordingly, there can be no assurance that we will enter into an amendment and restatement of our senior credit facility on the terms described above or at all. However, it is a condition to our obligation to issue the notes that prior to the issue date of the notes our senior credit facility is amended to permit the liens on the escrowed funds securing the notes.

To provide certainty of financing to fund the Crown Acquisition in the event the anticipated sources of funds for the Crown Acquisition are unavailable for any reason, we have entered into an interim loan agreement (or bridge facility) with affiliates of the underwriters. The bridge facility provides for aggregate credit facilities of $1.875 billion. These loans may be borrowed, if at all, only in connection with the closing of the Crown Acquisition. We expect to borrow under the bridge facility only if any or all of the anticipated permanent financing is not available for any reason and we are unable to replace such anticipated financing with alternate financing or available cash resources.

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The Offering

A brief description of the material terms of the offering follows. For a more complete description of the notes offered hereby, see Description of the Notes and the Guarantees in this prospectus supplement and Description of Debt Securities in the accompanying prospectus.

Issuer	Constellation Brands, Inc.
Subsidiary Guarantors	The notes will be guaranteed by our subsidiaries that are guarantors under our senior credit facility.
Securities Offered	$650,000,000 aggregate principal amount of 4.625% Senior Notes due 2023.
Maturity	The notes will mature on March 1, 2023.
Interest	Interest on the notes will accrue from August 14, 2012 and will be payable on March 1 and September 1 of each year, beginning March 1, 2013.
Ranking	Except as described below under Escrow of Proceeds, the notes will be our senior unsecured obligations and will rank equally with all of our other senior unsecured indebtedness and will be effectively subordinated to the indebtedness outstanding under our senior credit facility from time to time and any other secured debt we may incur to the extent of the value of the assets securing such debt. The notes will be fully and unconditionally guaranteed on a senior basis, jointly and severally, by the subsidiaries that are guarantors under our senior credit facility, subject to release provisions described below. Each guarantee will be effectively subordinated to any secured obligations of the subsidiary guarantors to the extent of the value of the assets securing such debt. The notes will also be structurally subordinated to all indebtedness and other liabilities of our subsidiaries that do not guarantee the notes.
	As of May 31, 2012, as adjusted to give effect to the issuance of the notes and the incurrence of additional senior secured financing in the aggregate amount of approximately $1.2 billion in connection with the Crown Acquisition, we would have had approximately (i) $5.3 billion aggregate principal amount of senior indebtedness outstanding, of which approximately $2.1 billion was secured (excluding the security interest in the proceeds of the sale of the notes held in escrow) and (ii) $160.4 million of available undrawn revolving commitments under the revolving portion of our senior credit facility (after giving effect to $650.0 million of assumed borrowings under our revolving facility to fund a portion of the Crown Acquisition). The guarantee of a subsidiary guarantor will be released to the extent such subsidiary guarantor is released as a guarantor under our senior credit facility or the facility (or a successor thereto) is amended, refinanced, extended, substituted, replaced or renewed without such subsidiary guarantor being a guarantor of the indebtedness thereunder, or if our senior credit facility is otherwise terminated or the requirements for legal or covenant defeasance or to discharge the indenture have been met.

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Optional Redemption	We may, at our option, redeem some or all of the notes at any time at a redemption price equal to the greater of 100% of the principal amount of the notes being redeemed; and the sum of the present values of the remaining scheduled payments of principal and interest on the notes being redeemed (excluding interest accrued to the redemption date) from the redemption date to the maturity date discounted to the date of redemption on a semi-annual basis (assuming a 360-day year consisting of twelve 30-day months) at a discount rate equal to the Treasury Rate (as defined in this prospectus supplement) plus 50 basis points. We will also pay the accrued and unpaid interest on the notes to the redemption date.
Escrow of Proceeds	An amount equal to the aggregate public offering price of the notes will be placed in an escrow account, which account will be pledged to the trustee for the benefit of the holders of the notes for so long as the proceeds remain in escrow. The escrowed funds will be used to fund a portion of the Crown Acquisition or the Alternate Crown Acquisition. See Description of the Notes and the Guarantees Escrow of Proceeds; Release Conditions.
Special Mandatory Redemption	If the Membership Interest Purchase Agreement is terminated and the transactions contemplated thereby are abandoned or if neither the Crown Acquisition nor the Alternate Crown Acquisition has been consummated or on prior to December 30, 2013, we will be required to redeem all of the notes at a redemption price equal to 100% of their aggregate public offering price, plus accrued and unpaid interest (and, if applicable, the accreted portion of any original issue discount) to the date of the special mandatory redemption. See Description of the Notes and the Guarantees Special Mandatory Redemption.
Repurchase at the Option of Holders Upon A Change of Control	If we experience a change of control (as defined in this prospectus supplement), we must offer to repurchase all the notes at a purchase price equal to 101% of the principal amount, plus accrued and unpaid interest, if any, to the repurchase date. We might not be able to pay you the required price for notes you present to us at the time of a change of control because our senior credit facility or other indebtedness may prohibit payment or we might not have enough funds at that time.
Sinking Fund	None.

Covenants	The indenture under which we will issue the notes contains covenants that, among other things, limit our ability under certain circumstances to create liens, enter into sale-leaseback transactions and engage in mergers, consolidations and sales of all or substantially all of our assets. See Description of the Notes and the Guarantees.
Use of Proceeds	We intend to use the net proceeds of the offering to fund a portion of the Crown Acquisition or the Alternate Crown Acquisition. See Use of Proceeds.
Risk Factors	An investment in the notes involves a high degree of risk. Potential investors should carefully consider the risk factors set forth under the heading Risk Factors and in the documents incorporated by reference herein prior to making a decision to invest in the notes.

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Summary Historical and Combined Financial Data of the Company and Crown

Set forth below is selected summary financial data of the Company for the fiscal year ended February 29, 2012, for the three month periods ended May 31, 2011 and 2012 and for the twelve month period ended May 31, 2012. The income statement data for the fiscal year ended February 29, 2012 have been derived from our audited historical financial statements incorporated by reference into this prospectus supplement. The income statement data for the three month periods ended May 31, 2011 and 2012 have been derived from our unaudited financial statements incorporated by reference into this prospectus supplement. The income statement data for the twelve month period ended May 31, 2012 have been derived from our audited and unaudited financial statements. In the opinion of our management, the unaudited data includes all adjustments (consisting of only normal recurring adjustments) necessary to present fairly the data for such periods. It is important that you read the summary historical financial data presented below along with Management s Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements incorporated by reference into this prospectus supplement.

The information set forth below under Selected Combined Financial Data of the Company and Crown reflects certain adjustments relating to the Crown Acquisition and the proposed financing of the Crown Acquisition, as described in this prospectus supplement, to the historical financial data of the Company. Such combined financial data is not required to be included in this prospectus supplement by, and has not been prepared in accordance with the provisions of, Regulation S-X promulgated by the Securities and Exchange Commission with respect to pro forma financial information relating to business combinations. Such combined financial data does not reflect the acquisition method of accounting and other adjustments required by Regulation S-X and you should not place undue reliance on it. Additionally, such combined financial data does not purport to represent what our results of operations or financial condition would have actually been had the Crown Acquisition been consummated prior to such periods or to project the Company s results of operations or financial condition for any future period if the Crown Acquisition is consummated.

($ in millions)	Twelve Months Ended May 31, 2012	Three Months Ended May 31, 2012	Three Months Ended May 31, 2011	Fiscal Year Ended February 29, 2012
Income Statement Data:	(unaudited)	(unaudited)		
Sales	$ 2,993.7	$ 725.3	$ 710.7	$ 2,979.1
Less excise taxes	(339.9)	(90.5)	(75.4)	(324.8)
Net sales	2,653.8	634.8	635.3	2,654.3
Cost of product sold	(1,592.1)	(384.2)	(384.3)	(1,592.2)
Gross profit	1,061.7	250.6	251.0	1,062.1
Selling, general and administrative expenses	(527.3)	(144.0)	(138.2)	(521.5)
Impairment of intangible assets	(38.1)			(38.1)
Restructuring charges	(5.4)	(0.5)	(11.1)	(16.0)
Operating income	490.9	106.1	101.7	486.5
Equity in earnings of equity method investees	226.9	60.6	62.2	228.5
Interest expense, net	(187.4)	(50.7)	(44.3)	(181.0)
Loss on write-off of financing costs	(2.8)	(2.8)		
Income before income taxes	527.6	113.2	119.6	534.0
Provision for income taxes	(85.1)	(41.2)	(45.1)	(89.0)
Net income	$ 442.5	$ 72.0	$ 74.5	$ 445.0

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($ in millions)	Twelve Months Ended May 31, 2012 (unaudited)	Three Months Ended May 31, 2012 (unaudited)	2011	Fiscal Year Ended February 29, 2012
Other Company Historical Financial Data:				
Comparable Basis EBITDA[(a) (d)]	$ 873.8	$ 199.7	$ 204.4	$ 878.5
Selected Combined Financial Data of the Company and Crown:				
Combined Comparable Basis EBITDA[(b) (d)]	$ 1,094.3	$ 262.5	$ 264.9	$ 1,096.7
Total Debt As Adjusted[(c)]	$ 5,296.0			
Ratio of Total Debt As Adjusted to Combined Comparable Basis EBITDA	4.8x			

(a) Comparable Basis EBITDA, a measure used by management to evaluate operating performance, is defined as net income of the Company before provision for income taxes, interest expense, net, depreciation and amortization and certain other items, as further detailed in footnote (d) below. Comparable Basis EBITDA is not a recognized term under GAAP and does not purport to be an alternative to net income as a measure of operating performance or to cash flows from operating activities as a measure of liquidity. Additionally, Comparable Basis EBITDA is not intended to be a measure of free cash flow available for management s discretionary use, as it does not consider certain cash requirements such as interest payments, tax payments and other debt service requirements. Management believes Comparable Basis EBITDA is helpful to investors and our management in highlighting trends because Comparable Basis EBITDA excludes the results of decisions outside the control of operating management and that can differ significantly from company to company depending on long-term strategic decisions regarding capital structure, the tax jurisdictions in which companies operate and capital investments. Management compensates for the limitations of using non-GAAP financial measures by using them to supplement GAAP results to provide a more complete understanding of the factors and trends affecting the business than GAAP results alone. Because not all companies use identical calculations, our presentation of Comparable Basis EBITDA may not be comparable to similarly titled measures of other companies.

(b) Combined Comparable Basis EBITDA represents Comparable Basis EBITDA (as defined in footnote (a) above) minus equity in earnings of Crown plus operating income and depreciation and amortization of Crown, in each case, for the applicable period. Combined Comparable Basis EBITDA is a non-GAAP financial measure. See footnote (a) above.

(c) Represents the Company s historical debt balance as of May 31, 2012 increased by the amount of additional debt assumed to be incurred to finance the Crown Acquisition. See Capitalization.

(d) The table below provides reconciliations of Comparable Basis EBITDA and Combined Comparable Basis EBITDA, which are non-GAAP financial measures, to GAAP net income for the periods presented in the table below. Non-GAAP financial measures should be viewed in addition to, and not as an alternative for, the Company s reported results prepared in accordance with GAAP.

(in millions)	Twelve Months Ended May 31, 2012	Three Months Ended May 31, 2012	2011	Fiscal Year Ended February 29, 2012
Net income	$ 442.5	$ 72.0	$ 74.5	$ 445.0
Provision for income taxes	85.1	41.2	45.1	89.0
Interest expense, net	187.4	50.7	44.3	181.0
Depreciation and amortization	112.9	29.5	26.9	110.3
Impairment of intangible assets	38.1			38.1
Restructuring charges	5.4	0.5	11.1	16.0
Loss on write-off of financing costs	2.8	2.8		
Other[(1)]	(0.4)	3.0	2.5	(0.9)
Comparable Basis EBITDA	**$ 873.8**	**$ 199.7**	**$ 204.4**	**$ 878.5**
Equity in earnings of Crown	(216.2)	(60.9)	(59.8)	(215.1)
Crown operating income	434.2	123.0	119.8	431.0
Crown depreciation and amortization	2.5	0.7	0.5	2.3
Combined Comparable Basis EBITDA	**$ 1,094.3**	**$ 262.5**	**$ 264.9**	**$ 1,096.7**

(1) Comprised of the flow through of inventory step-up associated with an acquisition; other costs incurred in connection with certain restructuring activities; gains and/or losses in connection with the disposal of businesses; losses on the contractual obligation created by the notification by a shareholder of Ruffino

S.r.l. (Ruffino) to exercise its option to put its entire equity interest in Ruffino to the Company; net gains in connection with the acquisition of the remaining portion of Ruffino; and gains in connection with releases from certain contractual obligations.

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Summary Historical Financial Information of Crown

The following table sets forth selected summary financial data of Crown for the twelve month period ended February 29, 2012, for the three month periods ended May 31, 2011 and 2012 and for the twelve month period ended May 31, 2012. The income statement data for the twelve month periods ended February 29, 2012 and May 31, 2012 and for the three month periods ended May 31, 2011 and 2012 have been derived from our audited and unaudited financial statements incorporated by reference into this prospectus supplement. It is important that you read the summary historical financial data presented below along with Management s Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements incorporated by reference into this prospectus supplement.

(in millions)	**Twelve Months Ended May 31, 2012**	**Three Months Ended May 31,**		**Twelve Months Ended February 29, 2012**
		2012	**2011**	
	(unaudited)	**(unaudited)**		
Income Statement Data:				
Net sales	$ 2,516.1	$ 724.1	$ 677.5	$ 2,469.5
Gross profit	$ 732.6	$ 211.2	$ 199.6	$ 721.0
Operating income	$ 434.2	$ 123.0	$ 119.8	$ 431.0
Net income	$ 433.4	$ 122.8	$ 119.6	$ 430.2

RISK FACTORS

You should carefully consider the risks described below and in our documents filed with the SEC and incorporated by reference herein, as well as other information included in this prospectus supplement, the accompanying prospectus and the documents incorporated by reference in this prospectus supplement and the accompanying prospectus before buying any of the notes.

Risks Relating to The Company

You should carefully consider the risk factors and other cautionary statements included in our annual report on Form 10-K for the fiscal year ended February 29, 2012, in our quarterly report on Form 10-Q for the fiscal quarter ended May 31, 2012 and in other documents filed with the SEC and incorporated by reference herein.

Risks Relating to The Notes

The notes are unsecured and will be effectively subordinated to our secured debt to the extent of the value of the assets securing such debt.

From and after the release of the proceeds of the notes from the escrow account, the notes will not be secured by any of our assets. As of May 31, 2012, as adjusted to give effect to the issuance of the notes and the incurrence of additional senior secured financing in the aggregate amount of approximately $1.2 billion in connection with the Crown Acquisition, we would have had approximately $2.1 billion of secured debt (excluding the security interest in the proceeds of the sale of the notes held in escrow) and approximately $160.4 million of unused commitments (taking into account issued and outstanding revolving letters of credit of approximately $13.4 million and after giving effect to $650.0 million of assumed borrowings under the revolving facility to fund a portion of the Crown Acquisition) under our revolving credit facility. Our obligations under our senior credit facility are currently secured by a pledge of (i) 100% of the ownership interests of certain of our U.S. subsidiaries and (ii) 55-65% of certain interests of certain of our foreign subsidiaries. In addition, the indenture governing the notes will permit us and our subsidiaries to incur certain additional debt that is secured by liens on our assets without equally and ratably securing the notes. If the Company becomes insolvent or is liquidated, or if payment under our secured debt is accelerated, the holders of our secured debt would be entitled to exercise the remedies available to a secured lender under applicable law and pursuant to the agreement governing such debt. In any such event, because the notes will not be secured by any of our assets, it is possible that there would be no assets remaining from which claims of the holders of the notes could be satisfied following repayment of our secured debt or, if any such assets remained, such assets might be insufficient to satisfy such claims fully.

Our ability to make payments on the notes depends on our ability to receive dividends from our subsidiaries, and not all of our subsidiaries are guarantors of the notes. The notes will be structurally subordinated to all indebtedness and other liabilities of our subsidiaries that do not guarantee the notes.

We are a holding company and conduct almost all of our operations through our subsidiaries. As of May 31, 2012, approximately 84% of our tangible assets were held by our subsidiaries. The ownership interests of our subsidiaries represent substantially all the assets of the holding company. Accordingly, we are dependent on the cash flows of our subsidiaries to meet our obligations, including the payment of the principal and interest on the notes. See Description of the Notes and the Guarantees.

The notes will be guaranteed, jointly and severally, by our subsidiaries that guarantee our senior credit facility. Holders of the notes will not have a direct claim on assets of subsidiaries that do not guarantee the notes and the notes will be structurally subordinated to all indebtedness and liabilities of our subsidiaries that do not guarantee the notes. For the three months ended May 31, 2012, approximately $127.7 million of our net sales were from our subsidiaries that are not guarantors of the notes. As of May 31, 2012, our non-guarantor subsidiaries had approximately $398.8 million of liabilities.

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The subsidiary guarantees may be subject to challenge under fraudulent transfer laws.

Under U.S. bankruptcy law and comparable provisions of state fraudulent transfer laws, a court could subordinate or void any guarantee if it found that the guarantee was incurred with actual intent to hinder, delay or defraud creditors or the guarantor did not receive fair consideration or reasonably equivalent value for the guarantee and the guarantor was any of the following: (i) insolvent or was rendered insolvent because of the guarantee; (ii) engaged in a business or transaction for which its remaining assets constituted unreasonably small capital; or (iii) intending to incur, or believed that it would incur, debts beyond its ability to pay at maturity. To the extent any guarantee were to be voided as a fraudulent conveyance or held unenforceable for any other reason, holders of the notes would cease to have any claim in respect of such guarantor and would be creditors solely of us and any guarantor whose guarantee was not voided or held unenforceable. In such event, the claims of the holders of the notes against the issuer of an invalid guarantee would be subject to the prior payment of all liabilities of such guarantor. There can be no assurance that, after providing for all prior claims, there would be sufficient assets to satisfy the claims of the holders of the notes relating to any voided guarantee.

In the event of a special mandatory redemption, holders of the notes may not obtain their expected return on the notes.

If we redeem the notes pursuant to the special mandatory redemption provisions, you may not obtain your expected return on the notes and may not be able to reinvest the proceeds from such special mandatory redemption in an investment that results in a comparable return. In addition, as a result of the special mandatory redemption provisions of the notes, the trading prices of the notes between the date of issuance and the consummation of the Crown Acquisition or Alternate Crown Acquisition may not reflect the financial results of our business or macroeconomic factors and may be limited based on the special mandatory redemption price. You will have no rights under the special mandatory redemption provisions if the Crown Acquisition closes, nor will you have any right to require us to repurchase your notes if, between the closing of this offering and the closing of the Crown Acquisition or Alternate Crown Acquisition, we experience any changes (including any material changes) in our business or financial condition, or if the terms of the Membership Interest Purchase Agreement change in any way that is not materially adverse to the holders of the notes.

There is no public market for the notes, an active trading market for the notes may not develop and the market price of the notes may be lower than the offering price.

The notes will constitute a new issue of securities with no established trading market, and there can be no assurance as to (i) the liquidity of any such market that may develop, (ii) the ability of holders of notes to sell their notes or (iii) the price at which the holders of notes would be able to sell their notes. If such a market were to exist, the notes could trade at prices that may be higher or lower than their principal amount or purchase price, depending on many factors, including prevailing interest rates, the market for similar notes and our financial performance. We have been advised by the underwriters that, following completion of this offering, the underwriters presently intend to make a market in the notes. However, the underwriters are not obligated to do so, and any market-making activity with respect to the notes may be discontinued at any time without notice. In addition, such market-making activity will be subject to the limits imposed by the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended. There can be no assurance that an active trading market will exist for the notes.

The subsidiary guarantees may be limited in duration.

Each subsidiary guarantor will guarantee our obligations under the notes only for so long as each subsidiary guarantor is a guarantor under our senior credit facility. If any or all of the subsidiary guarantees are released or terminated or no longer required under our senior credit facility, such subsidiary guarantee(s) will be released under the indenture. The indenture does not contain any covenants that materially restrict our ability to sell, transfer or otherwise dispose of our assets, including the ownership interests of our subsidiaries, or the assets of any of our subsidiaries, except as described under the caption Description of Debt Securities Consolidation, Merger, Sale or Conveyance in the accompanying prospectus.

We may not be able to repurchase the notes upon a change of control.

Upon the occurrence of specific kinds of change of control events, each holder of notes will have the right to require us to repurchase all or any part of such holder s notes at a price equal to 101% of their principal amount, plus accrued and unpaid interest, if any, to the repurchase date. Our senior credit facility currently also provides that certain change of control events constitute a default. Any future credit agreement or other agreements relating to indebtedness to which we become a party may contain similar provisions. If we experience a change of control that triggers a default under our senior credit facility, such default could result in amounts outstanding under our senior credit facility being declared due and payable. We would be prohibited from purchasing the notes unless, and until, such time as our indebtedness under our senior credit facility was repaid in full. There can be no assurance that either we or our subsidiary guarantors would have sufficient financial resources available to satisfy all of our or their obligations under our senior credit facility and these notes in the event of a change of control. Our failure to purchase the notes as required under the indenture governing the notes would result in a default under the indenture, which could have material adverse consequences for us and the holders of the notes. See Description of the Notes and the Guarantees Repurchase at the Option of Holders Upon a Change of Control.

If a bankruptcy or reorganization case is commenced, bankruptcy laws may delay or prevent the escrow agent from releasing the escrowed funds.

If we or any of our subsidiaries commence a bankruptcy or reorganization case, or one is commenced against us, the applicable bankruptcy laws may delay or prevent the trustee under the indenture governing the notes from foreclosing on, and the escrow agent from releasing, the escrowed funds. Under the applicable bankruptcy laws, secured creditors, such as the trustee on behalf of the holders of the notes, are prohibited from foreclosing upon or disposing of a debtor s property without prior bankruptcy court approval.

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USE OF PROCEEDS

We estimate that the net proceeds from the sale of the notes will be approximately $641.0 million (after deducting underwriter discounts and commissions and estimated offering expenses). We intend to use the net proceeds from this offering to pay a portion of the Crown Acquisition or the Alternate Crown Acquisition purchase price. Pending such use, an amount equal to the aggregate public offering price of the notes will be placed in an escrow account, which account will be pledged to the trustee for the benefit of the holders of the notes for so long as the proceeds remain in escrow. If the Membership Interest Purchase Agreement is terminated and the transactions contemplated thereby are abandoned or if neither the Crown Acquisition nor the Alternate Crown Acquisition has been consummated on or prior to December 30, 2013, the funds in the escrow account will be used toward redemption of all of the notes at a redemption price equal to 100% of their aggregate public offering price, plus accrued and unpaid interest (and, if applicable, the accreted portion of any original issue discount) to the date of the special mandatory redemption. See Description of the Notes and the Guarantees Escrow of Proceeds; Release Conditions and Description of the Notes and the Guarantees Special Mandatory Redemption.

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CAPITALIZATION

The following table sets forth, as of May 31, 2012, our consolidated cash and cash equivalents and total capitalization on (i) an actual basis; and (ii) as adjusted to give effect to the issuance of the notes and the incurrence of additional senior secured financing in the aggregate amount of approximately $1.2 billion in connection with the Crown Acquisition. See Prospectus Supplement Summary Recent Developments Financing Arrangements for the Crown Acquisition. You should read this table in conjunction with our consolidated financial statements and the related notes which are incorporated by reference in this prospectus supplement and the accompanying prospectus.

(in millions)	May 31, 2012 Actual	(Unaudited) As Adjusted For The Notes Issuance And The Additional Financing
Cash and Cash Equivalents	$ 69.1	$ 69.1
Long-Term Debt (including current portion):		
Revolving Credit Facility	$ 26.2	$ 676.2
Term Loan A	550.0	550.0
Term Loan A-1	250.0	250.0
New Term Loan		575.0
Other Senior Debt	99.8	99.8
4.625% Senior Notes due 2023 offered hereby		650.0
8.375% Senior Notes due 2014[(a)]	498.6	498.6
7.250% Senior Notes due 2016[(b)]	696.4	696.4
7.250% Senior Notes due 2017	700.0	700.0
6.000% Senior Notes due 2022	600.0	600.0
Total Debt	3,421.0	5,296.0
Stockholders Equity	2,299.8	2,299.8
Total Capitalization	$ 5,720.8	$ 7,595.8

(a) Represents $500.0 million less $1.4 million unamortized discount.
(b) Represents $700.0 million less $3.6 million unamortized discount.

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DESCRIPTION OF THE NOTES AND THE GUARANTEES

The following discussion of the terms of the notes supplements the description of the general terms and provisions of the debt securities contained in the accompanying prospectus and identifies any general terms and provisions described in the accompanying prospectus that will not apply to the notes.

Unless the context requires otherwise, references in this section to we, us, our and the Company refer to Constellation Brands, Inc. only and not to its subsidiaries. Unless otherwise defined herein, capitalized terms used in the description below have the definitions given to them under Certain Definitions below.

General

The notes will be issued under an indenture and supplemental indenture thereto, together referred to below as the indenture, among us, Manufacturers and Traders Trust Company, and the guarantors named therein. You should read the accompanying prospectus for a general discussion of the terms and provisions of the indenture.

The indenture does not limit the amount of notes, debentures or other evidences of indebtedness that we may issue thereunder and provides that notes, debentures or other evidences of indebtedness may be issued from time to time thereunder in one or more series. We are initially offering the notes in the principal amount of $650,000,000. At any time following the consummation of the Crown Acquisition or Alternate Crown Acquisition, we may, without the consent of the holders, issue additional notes (which are referred to as such below) and thereby increase that principal amount in the future, on the same terms and conditions and with the same CUSIP number as the notes we offer by this prospectus supplement.

The notes will mature on March 1, 2023 and will bear interest at a rate of 4.625% per year. Interest on the notes will accrue from August 14, 2012 or from the most recent interest payment date to which interest has been paid or duly provided for. We will pay interest on the notes semi-annually on March 1 and September 1 of each year, beginning March 1, 2013. In each case, we:

- will pay interest to the person in whose name a note is registered at the close of business on the February 15 or August 15 preceding the interest payment date;
- will compute interest on the basis of a 360-day year consisting of twelve 30-day months;
- will make payments on the notes at the offices of the trustee; and
- may make payments by wire transfer for notes held in book-entry form or by check mailed to the address of the person entitled to the payment as it appears in the note register.

If any interest payment date or maturity or redemption date falls on a day that is not a business day, the required payment shall be made on the next business day as if it were made on the date such payment was due and no interest shall accrue on the amount so payable from and after such interest payment date or maturity or redemption date, as the case may be, to such next business day. Business day means any day that is not a day on which banking institutions in The City of New York are authorized or required by law or by executive order issued by a governmental authority or agency regulating such banking institutions, to close.

We will issue the notes only in fully registered form, without coupons, in denominations of $2,000 and any integral multiple of $1,000 in excess thereof.

Escrow of Proceeds; Release Conditions

This offering will be consummated prior to the consummation of the Crown Acquisition or, if applicable, the Alternate Crown Acquisition. Concurrently with the closing of this offering, we will enter into an escrow agreement (the *Escrow Agreement*) with the trustee and

Manufacturers Traders and Trust Company, as escrow

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agent (in such capacity, the *Escrow Agent*). Pursuant to the Escrow Agreement, we will deposit an amount of cash equal to the aggregate public offering price of the notes with the Escrow Agent (collectively, with any other property from time to time held by the Escrow Agent, the *Escrowed Property*), for deposit into the Escrow Account. We will not prefund interest or original issue discount that may accrete on the notes during the pendency of the Escrow Agreement. We will grant the trustee, for the benefit of the holders of the notes, a security interest in the Escrow Account and the Escrowed Property to secure our obligations under the notes pending disbursement as described below. The Escrowed Property will be required to be invested in cash or certain U.S. dollar denominated short term investments pursuant to the Escrow Agreement.

In order to cause the Escrow Agent to release the Escrowed Property to us (the *Release*), we must deliver to the Escrow Agent and the trustee an officer s certificate certifying that the closing of the Crown Acquisition or the Alternate Crown Acquisition is expected to occur in accordance with the terms of the Membership Interest Purchase Agreement (and without any amendment, waiver or modification thereof that is materially adverse to the holders of the notes) within five business days following the date of such officer s certificate and we have received or waived the notice contemplated by the Membership Interest Purchase Agreement of the anticipated closing date of the acquisition of Grupo Modelo by Anheuser-Busch InBev. In the event that the Crown Acquisition or Alternate Crown Acquisition is not actually consummated within seven business days following a Release, we will be required to redeposit all Escrowed Property with the Escrow Agent (subject to our right to cause a subsequent Release in accordance with the foregoing requirements).

Subsidiary Guarantees

Our obligations under the indenture and the notes, including the payment of principal of, and premium, if any, and interest on, the notes, will be fully and unconditionally guaranteed by the subsidiaries that are guarantors under our senior credit facility, provided that the guarantee of a subsidiary guarantor will be released to the extent such subsidiary guarantor is released as a guarantor under our senior credit facility or the facility (or a successor thereto) is amended, refinanced, extended, substituted, replaced or renewed without such subsidiary guarantor being a guarantor of the indebtedness thereunder, or if our senior credit facility is otherwise terminated or the requirements for legal or covenant defeasance or to discharge the indenture have been met.

The subsidiary guarantors guarantees will be joint and several obligations.

The guarantees will be senior unsecured obligations of each subsidiary guarantor and will rank equally with all of the other senior unsecured obligations of the subsidiary guarantor. Each guarantee will be effectively subordinated to any secured obligations of the subsidiary guarantors. The obligations of each subsidiary guarantor under its guarantee will provide that it be limited as necessary to prevent that guarantee from constituting a fraudulent conveyance under applicable law.

If a guarantee were rendered voidable, it could be subordinated by a court to all other liabilities and obligations (including guarantees and other contingent liabilities) of the applicable subsidiary guarantor, and depending on the amount of such liabilities and obligations, a subsidiary guarantor s liability on its guarantee could be reduced to zero.

The indenture will not contain any restrictions on the ability of any subsidiary guarantor to (i) pay dividends or distributions on, or redeem, purchase, acquire, or make a liquidation payment with respect to, any of that subsidiary guarantor s ownership interests, (ii) make any payment of principal, premium, if any, or interest on or repay, repurchase or redeem any debt securities of that subsidiary guarantor or (iii) consolidate with, merge with or into, or transfer all or substantially all of its assets to another person or entity. If a subsidiary guarantor is merged or consolidated with or into another person that is the surviving company in that merger or consolidation and (a) the surviving company becomes a guarantor under our senior credit facility, then the indenture will

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require that the surviving company expressly assume the obligations of the subsidiary guarantor under its guarantee or (b) the surviving company is not a guarantor under our senior credit facility and we deliver an officer s certificate to the trustee to that effect, then the surviving company will be released from any obligations under the guarantee of the subsidiary which was so merged or consolidated.

Ranking

Except as described above under Escrow of Proceeds; Release Conditions, the notes will be our senior unsecured obligations and will rank equally with all of our other senior unsecured indebtedness and will be effectively subordinated to the indebtedness outstanding under our senior credit facility from time to time and any other secured debt we may incur. The notes will be fully and unconditionally guaranteed on a senior basis, jointly and severally, by the subsidiaries that are guarantors under our senior credit facility, subject to the release provisions described above. Each guarantee will be effectively subordinated to any secured obligations of the subsidiary guarantors to the extent of the value of the assets securing such debt. These subsidiary guarantors also guarantee our obligations under our senior credit facility. Our senior credit facility is currently secured by a pledge of the ownership interests of certain of our subsidiaries and by certain intercompany debt subject to certain tax exclusions. The notes will also be structurally subordinated to all indebtedness and other liabilities of our subsidiaries that do not guarantee the notes.

We are a holding company and conduct almost all of our operations through our subsidiaries. Consequently, our ability to pay our obligations, including our obligation to pay interest on the notes and to repay the principal amount of the notes at maturity, upon redemption, upon acceleration or otherwise will depend upon our subsidiaries earnings and advances or loans made by them to us (and potentially dividends or distributions made by them to us). Our subsidiaries are separate and distinct legal entities and, except for the subsidiary guarantors obligations under the subsidiary guarantees, have no obligation, contingent or otherwise, to pay any amounts due on the notes or to make funds available to us to do so. Our subsidiaries ability to make advances or loans to us or to pay dividends or make other distributions to us will depend upon their operating results and will be subject to applicable laws and contractual restrictions, if any. The indenture will not limit our subsidiaries ability to enter into other agreements that prohibit or restrict dividends or other payments or advances to us. Except with respect to the covenants described below under Limitation upon Liens and Limitation on Sale and Leaseback Transactions , the indenture does not restrict or limit the ability of any subsidiary to incur, create, assume or guarantee indebtedness or encumber its assets or properties. As of May 31, 2012, as adjusted to give effect to the issuance of the notes and the incurrence of additional senior secured financing in the aggregate amount of approximately $1.2 billion in connection with the Crown Acquisition, we would have had approximately (i) $5.3 billion aggregate principal amount of senior indebtedness outstanding, of which approximately $2.1 billion was secured (excluding the security interest in the proceeds of the sale of the notes held in escrow) and (ii) $160.4 million of unused commitments (taking into account issued and outstanding revolving letters of credit of approximately $13.4 million and after giving effect to $650.0 million of assumed borrowings under our revolving facility to fund a portion of the Crown Acquisition) under our revolving credit facility.

Special Mandatory Redemption

If (i) on December 30, 2013 (the *Outside Date*) neither the Crown Acquisition nor the Alternate Crown Acquisition has been consummated or (ii) at any time prior to the consummation of the Crown Acquisition or the Alternate Crown Acquisition and the Outside Date, we deliver an officer s certificate to the Escrow Agent stating that we have elected not to consummate the Crown Acquisition or the Alternate Crown Acquisition or that we have determined that the conditions required for Release cannot be satisfied, then the Escrow Agreement shall terminate on such date (the *Escrow Termination Date*). On the Business Day following the Escrow Termination Date (the *Special Mandatory Redemption Date*), the Escrow Agent shall distribute all Escrowed Property to the trustee and we will be required to fund any additional amounts to the trustee necessary to fund the redemption described below. The trustee shall apply the amounts so received pursuant to the previous sentence to redeem all outstanding notes at a redemption price equal to the public offering price of the notes as set forth on the cover page of this prospectus supplement, plus accrued and unpaid interest and, if applicable, accretion of any original issue discount on the notes (calculated assuming such original issue discount is amortized over the full term of the notes and compounded on each interest payment date), if any, to, but excluding, the Special Mandatory Redemption Date. The Trustee will pay to us any Escrowed Property, if any, remaining after redemption of the notes and payment of its fees and expenses.

Optional Redemption

We may redeem the notes in whole or in part at any time or in part from time to time, at our option, at a redemption price equal to the greater of

- 100% of the principal amount of the notes to be redeemed; and

- the sum of the present values of the remaining scheduled payments of principal and interest (excluding interest accrued to the redemption date) on the notes discounted to the date of redemption on a semi-annual basis (assuming a 360-day year consisting of twelve 30-day months) at the applicable Treasury Rate plus 50 basis points,

plus, in each case, accrued and unpaid interest on the principal amount being redeemed to the redemption date.

Treasury Rate means, with respect to any redemption date, (1) the yield, under the heading which represents the average for the immediately preceding week, appearing in the most recently published statistical release designated H.15(519) or any successor publication which is published weekly by the Board of Governors of the Federal Reserve System and which establishes yields on actively traded United States Treasury securities adjusted to constant maturity under the caption Treasury Constant Maturities, for the maturity corresponding to the Comparable Treasury Issue (if no maturity is within three months before or after the remaining life, yields for the two published maturities most closely corresponding to the Comparable Treasury Issue will be determined and the Treasury Rate will be interpolated or extrapolated from such yields on a straight line basis, rounding to the nearest month) or (2) if such release (or any successor release) is not published during the week preceding the calculation date or does not contain such yields, the rate per year equal to the semi-annual equivalent yield-to-maturity of the Comparable Treasury Issue, calculated using a price for the Comparable Treasury Issue (expressed as a percentage of its principal amount) equal to the Comparable Treasury Price for such redemption date. The Treasury Rate will be calculated on the third Business Day preceding the redemption date.

Comparable Treasury Issue means the United States Treasury security selected by an Independent Investment Banker as having a maturity comparable to the remaining term of the notes to be redeemed.

Comparable Treasury Price means (1) the average of four Reference Treasury Dealer Quotations for such redemption date, after excluding the highest and lowest Reference Treasury Dealer Quotations, or (2) if the Independent Investment Banker obtains fewer than four such Reference Treasury Dealer Quotations, the average of all such quotations.

Independent Investment Banker means any of Merrill Lynch, Pierce, Fenner & Smith Incorporated, J.P. Morgan Securities LLC, Rabo Securities USA, Inc., Barclays Capital Inc. or Wells Fargo Securities, LLC and their successors, or, if Merrill Lynch, Pierce, Fenner & Smith Incorporated, J.P. Morgan Securities LLC, Rabo Securities USA, Inc., Barclays Capital Inc. or Wells Fargo Securities, LLC are unwilling or unable to select the Comparable Treasury Issue, an independent investment banking institution of national standing appointed by the trustee after consultation with us.

Reference Treasury Dealer means any of (1) Merrill Lynch, Pierce, Fenner & Smith Incorporated, J.P. Morgan Securities LLC, Rabo Securities USA, Inc., Barclays Capital Inc. or Wells Fargo Securities, LLC, or their successors; *provided, however*, that if Merrill Lynch, Pierce, Fenner & Smith Incorporated, J.P. Morgan Securities LLC, Rabo Securities USA, Inc., Barclays Capital Inc. or Wells Fargo Securities, LLC shall cease to be a primary U.S. Government securities dealer in New York City, which we refer to as a Primary Treasury Dealer , we will substitute another Primary Treasury Dealer and (2) any one other Primary Treasury Dealer selected by the Independent Investment Banker after consultation with us.

Reference Treasury Dealer Quotations means, with respect to each Reference Treasury Dealer and any redemption date, the average, as determined by the Independent Investment Banker, of the bid and asked prices for the Comparable Treasury Issue (expressed in each case as a percentage of its principal amount) quoted in writing to the Independent Investment Banker at 5:00 p.m., New York City time, on the third Business Day preceding such redemption date.

Holders of notes to be redeemed will be sent a redemption notice by first-class mail at least 30 and not more than 60 days before the date fixed for redemption. If fewer than all of the notes are to be redeemed, the trustee will select, not more than 60 days and not less than 30 days before the redemption date, the particular notes or portions of the notes for redemption from the outstanding notes not previously called by lot. Unless we default in payment of the redemption price, on and after the redemption date, interest will cease to accrue on the notes or portions of the notes called for redemption.

Repurchase at the Option of Holders Upon a Change of Control

Upon the occurrence of a Change of Control, each holder of notes will have the right to require us to repurchase all or any part of such holder s notes (except that no note will be purchased in part if the remaining principal amount of such note would be less than $2,000) pursuant to the offer described below (the *Change of Control Offer*) at a purchase price (the *Change of Control Purchase Price*) equal to 101% of the principal amount of the notes to be repurchased, plus accrued and unpaid interest to, but excluding, the repurchase date (subject to the right of holders of record on the relevant record date to receive interest due on the relevant interest payment date).

Within 30 days following any Change of Control, we will:

(a) cause a notice of the Change of Control Offer to be sent at least once to the Dow Jones News Service or similar business news service in the United States; and

(b) send, by first-class mail, with a copy to the trustee, to each holder of notes, at such holder s address appearing in the security register, a notice stating:

(1) that a Change of Control has occurred and a Change of Control Offer is being made pursuant to the covenant entitled Repurchase at the Option of Holders Upon a Change of Control and that all notes timely tendered will be accepted for payment;

(2) the Change of Control Purchase Price and the repurchase date, which will be, subject to any contrary requirements of applicable law, a business day no earlier than 30 days nor later than 60 days from the date the notice is mailed;

(3) the circumstances and relevant facts regarding the Change of Control (including information with respect to our *pro forma* consolidated historical income, cash flow and capitalization after giving effect to the Change of Control); and

(4) the procedures that holders of notes must follow in order to tender their notes (or portions thereof) for payment, and the procedures that holders of notes must follow in order to withdraw an election to tender notes (or portions thereof) for payment.

We will not be required to make a Change of Control Offer following a Change of Control if a third party makes the Change of Control Offer in the manner, at the times and otherwise in compliance with the requirements set forth in the indenture applicable to a Change of Control Offer made by us and purchases all notes validly tendered and not withdrawn under such Change of Control Offer.

We will comply, to the extent applicable, with the requirements of Section 14(e) of the Securities Exchange Act of 1934, as amended (the *Exchange Act*), and any other securities laws or regulations in connection with the repurchase of notes pursuant to a Change of Control Offer. To the extent that the provisions of any securities laws or regulations conflict with the provisions of this covenant, we will comply with the applicable securities laws and regulations and will not be deemed to have breached our obligations under this covenant by virtue of this compliance.

We have no present intention to engage in a transaction involving a Change of Control, although it is possible that we would decide to do so in the future. We could, in the future, enter into certain transactions, including acquisitions, refinancings or other recapitalizations, that would not constitute a Change of Control, but that could increase the amount of debt outstanding at such time or otherwise affect our capital structure or credit ratings.

The definition of Change of Control includes a phrase relating to the sale, transfer, assignment, lease, conveyance or other disposition of all or substantially all of our property. Although there is a developing body of case law interpreting the phrase substantially all, there is no precise established definition of the phrase under applicable law. Accordingly, if we and our subsidiaries, considered as a whole, dispose of less than all of our property by any of the means described above, the ability of a holder of notes to require us to repurchase its notes may be uncertain. In such a case, holders of the notes may not be able to resolve this uncertainty without resorting to legal action.

Sinking Fund

The notes will not have the benefit of any sinking fund.

Reports to the Trustee

We are required to provide the trustee with an officers certificate each fiscal year stating that we reviewed our activities during the preceding fiscal year and that, after reasonable investigation and inquiry by the certifying officers, we are in compliance with the requirements of the indenture and that no default exists or, if we know of a default, we must identify it.

Limitation Upon Liens

The indenture provides that, so long as any of the notes remain outstanding, we will not and will not permit any Subsidiary to issue, assume or guarantee any Funded Debt that is secured by a mortgage, pledge, security interest or other lien or encumbrance (a *lien*) upon or with respect to any Principal Property or on the Capital Stock of any Subsidiary that owns a Principal Property unless:

- we secure the notes equally and ratably with (or prior to) any and all Funded Debt secured by that lien, or

- in the case of Funded Debt other than Capital Markets Debt, immediately after giving effect to the granting of any such lien and the incurrence of any Funded Debt in connection therewith, the Company s Consolidated Fixed Charge Coverage Ratio would be greater than 2.0 to 1.0.

The above limitation will not apply to some types of permitted liens. These permitted liens include:

- liens existing as of the date of the issuance of the notes (excluding liens securing our senior credit facility);

- liens securing our senior credit facility in an amount not to exceed the maximum amount permitted to be outstanding under our existing senior credit facility (including the incremental facilities contemplated thereunder);

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- liens on property or assets of, or any shares of stock securing Funded Debt of, any corporation or other Person existing at the time such corporation or other Person becomes a Subsidiary;
- liens on property, assets or shares of stock securing Funded Debt existing at the time of an acquisition, including an acquisition through merger or consolidation, and liens to secure Funded Debt incurred prior to, at the time of or within 180 days after the later of the completion of the acquisition, or the completion of the construction and commencement of the operation of any such property, for the purpose of financing all or any part of the purchase price or construction cost of that property;
- liens to secure specified types of development, operation, construction, alteration, repair or improvement costs;
- liens in favor of, or which secure Funded Debt owing to, the Company or a Subsidiary;
- liens in connection with government contracts, including the assignment of moneys due or to come due on those contracts;
- certain types of liens in connection with legal proceedings;
- certain types of liens arising in the ordinary course of business and not in connection with the borrowing of money such as mechanics , materialmen s, carriers or other similar liens;
- liens on property securing obligations issued by a domestic governmental issuer to finance the cost of an acquisition or construction of that property; and
- extensions, substitutions, replacements, refinancings or renewals (or successive extensions, substitutions, replacements, refinancings or renewals), in whole or in part, of the foregoing or of Funded Debt secured in reliance on the second bullet point under the first paragraph above, in each case, if the principal amount of the Funded Debt secured thereby is not increased and is not secured by any additional assets.

Limitation on Sale and Leaseback Transactions

The indenture provides that, so long as any of the notes remain outstanding, neither we nor any Subsidiary may enter into any arrangement with any Person (other than ourselves or any Subsidiary) where we or a Subsidiary agree to lease any Principal Property which has been or is to be sold or transferred more than 120 days after the later of (i) such Principal Property having been acquired by us or a Subsidiary and (ii) completion of construction and commencement of full operation thereof, by us or a Subsidiary to that person (a *Sale and Leaseback Transaction*). Sale and Leaseback Transactions with respect to facilities financed with specified tax exempt securities are excepted from the definition. This covenant does not apply to leases of a Principal Property for a term of less than three years.

This limitation also does not apply to any Sale and Leaseback Transaction if:

- the net proceeds to the Company or a Subsidiary from the sale or transfer equal or exceed the fair value, as determined by our Board of Directors, of the Principal Property so leased,
- immediately after giving effect to such Sale and Leaseback Transaction, the Company s Consolidated Fixed Charge Coverage Ratio would be greater than 2.0 to 1.0, or

we, within 120 days after the effective date of the Sale and Leaseback Transaction, apply an amount equal to the fair value as determined by the Company s Board of Directors of the Principal Property so leased to:

- the prepayment or retirement of our Funded Debt, which may include the notes; or

- the acquisition of additional real property.

Events of Default

The events of default applicable to the notes will consist of the following:

- failure to pay the principal of, or premium, if any, on any of the notes when due and payable (whether at maturity, by call for redemption, by declaration of acceleration or otherwise);

failure to make a payment of any interest on any note when due and payable, which failure shall have continued for a period of 30 days;

our, or any subsidiary guarantor s, failure to perform or observe any other covenants or agreements in the indenture or in the notes which failure shall have continued for a period of at least 90 days after written notice to us or the guarantors, as the case may be, by the trustee or to us and the trustee from the holders of not less than 25% of the aggregate principal amount of the then outstanding notes *provided*, that, notwithstanding the foregoing, in no event shall an event of default with respect to any failure by us to comply with the reporting provisions of the indenture or any failure by us to comply with the requirements of Section 314(a)(1) of the Trust Indenture Act (which relates to the provision of reports) be deemed to have occurred unless (x) such report is past due hereunder by at least 180 days and (y) such failure to comply has not been cured or waived prior to the 90th day after written notice to us by the trustee or to us and the trustee from the holders of not less than 25% of the aggregate principal amount of the then outstanding notes;

failure to make any payment after the maturity of any indebtedness of ours with an aggregate principal amount in excess of $100.0 million or the acceleration of indebtedness of ours with an aggregate principal amount in excess of $100.0 million as a result of a default with respect to such indebtedness, and such indebtedness, in either case, is not discharged or such acceleration is not cured, waived, rescinded or annulled within a period of 30 days after we receive written notice;

certain events of bankruptcy, insolvency or reorganization of us; or

any guarantee of the notes of a subsidiary guarantor that is a significant subsidiary shall for any reason cease to be, or be asserted in writing by any subsidiary guarantor thereof or us not to be, in full force and effect, and enforceable in accordance with its terms except as provided in the indenture.

Modification of the Indenture

The indenture contains provisions permitting us, the subsidiary guarantors and the trustee to amend or supplement the indenture or the notes with the consent of the holders of a majority in principal amount of the notes then outstanding. If any additional notes are issued under the indenture, such notes would constitute part of the same series of debt securities as the notes offered hereby and would be included in determining whether the holders of the requisite percentage of notes had provided any instruction or consented to any amendment. However, any debt securities (other than additional notes) that may be issued under the indenture will not vote together with the notes and any additional notes that we issue. In any event, no amendment or supplement may, among other things, (a) extend the final maturity of any note, or reduce the rate or extend the time of payment of any interest on any note, or reduce the principal amount of any note, premium on any note, or reduce any amount payable upon any redemption of any note, or (b) reduce the percentage of principal amount of the notes that is required to approve an amendment or supplement to the indenture, without the consent of the holder of each note so affected.

Legal Defeasance

We may be discharged from any and all obligations in respect of the notes (except for certain obligations to register the transfer or exchange of notes, to replace stolen, destroyed, lost or mutilated notes, to maintain paying agencies, to compensate and indemnify the trustee and to furnish the trustee with the names and addresses of holders of notes), which we refer to as *defeasance*, if:

we irrevocably deposit with the trustee, in trust, cash and/or securities of the United States government, or securities of agencies of the United States government backed by the full faith and credit of the United States government, in an amount certified by a nationally recognized firm of independent public accountants to be sufficient to pay the principal of and interest on the notes on the applicable due dates for those payments in accordance with the terms of the notes;

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- we deliver to the trustee either (i) an opinion of counsel, based on a ruling of the United States Internal Revenue Service (unless there has been a change in the applicable United States federal income tax law), to the effect that the holders of the notes will not recognize income, gain or loss for United States federal income tax purposes as a result of such defeasance and will be subject to United States federal income tax on the same amounts and in the same manner and at the same times as would have been the case if the defeasance had not occurred or (ii) a ruling of the United States Internal Revenue Service directed to the trustee to the same effect as set forth in clause (i) above;

- immediately after giving effect to the deposit specified in the first bullet point, on a pro forma basis, no event of default with respect to the notes shall have occurred and be continuing on the date of deposit or, with respect to defaults occurring upon certain events of bankruptcy, insolvency or reorganization relating to us, at any time during the period ending on the 91st day after the date of the deposit; and

- we deliver to the trustee an officers certificate and an opinion of counsel each stating that we have complied with all of the above requirements.

Defeasance of Certain Obligations

We may omit to comply with certain covenants with respect to the notes, and any such omission will not constitute an event of default with respect to the notes, which we refer to as *covenant defeasance*, if:

- we irrevocably deposit with the trustee, in trust, cash and/or securities of the United States government, or securities of agencies of the United States government backed by the full faith and credit of the United States government, in an amount certified by a nationally recognized firm of independent public accountants to be sufficient to pay the principal of and interest on the notes on the applicable due dates for those payments in accordance with the terms of the notes;

- we deliver to the trustee an opinion of counsel to the effect that the holders of the notes will not recognize income, gain or loss for United States federal income tax purposes as a result of such covenant defeasance and will be subject to United States federal income tax on the same amounts and in the same manner and at the same times as would have been the case if the covenant defeasance had not occurred;

- immediately after giving effect to the deposit specified in the first bullet point, on a pro forma basis, no event of default with respect to the notes shall have occurred and be continuing on the date of the deposit or, with respect to defaults occurring upon certain events of bankruptcy, insolvency or reorganization relating to us, at any time during the period ending on the 91st day after the date of the deposit;

- if the notes are then listed on a national securities exchange, we deliver to the trustee an opinion of counsel to the effect that the notes will not be delisted as a result of such covenant defeasance; and

- we deliver to the trustee an officers certificate and an opinion of counsel each stating that we have complied with all of the above requirements.

If we exercise our option to effect a defeasance or covenant defeasance with respect to the notes, as described above, and the trustee or paying agent is unable to apply any money or securities that we have deposited because of any legal proceeding or any order or judgment of any court or governmental authority, in each case our obligations under the indenture and the notes will be revived and reinstated.

Certain Definitions

The terms set forth below are defined in the indenture as follows:

Board of Directors means our board of directors, the executive committee of our board of directors, any other duly authorized committee of our board of directors, or any of our officers duly authorized by our board of directors or by any duly authorized committee of our board of directors to act under the indenture.

Capital Lease Obligation means any obligations of us and our Subsidiaries on a Consolidated basis under any capital lease of real or personal property which, in accordance with GAAP, has been recorded as a capitalized lease obligation.

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Capital Markets Debt means any debt securities or debt financing issued pursuant to an indenture, notes purchase agreement or similar financing arrangement (but excluding any credit agreement) whether offered pursuant to a registration statement under the Securities Act or under an exemption from the registration requirements of the Securities Act.

Capital Stock means, with respect to any Person, any and all shares, interests, participations or other equivalents (however designated, whether voting or non-voting) in the equity of such Person, including, without limitation, all common stock and preferred stock.

Change of Control means the occurrence of any of the following events: (i) any person or group (as such terms are used in Sections 13(d) and 14(d) of the Exchange Act), other than Permitted Holders, is or becomes the beneficial owner (as defined in Rules 13d-3 and 13d-5 under the Exchange Act, except that a Person shall be deemed to have beneficial ownership of all shares that such Person has the right to acquire, whether such right is exercisable immediately or only after the passage of time), directly or indirectly, of more than 35% of the voting power of our total outstanding Voting Stock voting as one class, provided that the Permitted Holders beneficially own (as so defined) a percentage of Voting Stock having a lesser percentage of the voting power than such other Person and do not have the right or ability by voting power, contract or otherwise to elect or designate for election a majority of our Board of Directors; (ii) during any period of two consecutive years, individuals who at the beginning of such period constituted our Board of Directors (together with any new directors whose election to such Board or whose nomination for election by the shareholders was approved by a vote of $66^{2}/_{3}$% of the directors then still in office who were either directors at the beginning of such period or whose election or nomination for election was previously so approved) cease for any reason to constitute a majority of such Board of Directors then in office; (iii) we consolidate with or merge with or into any Person or convey, transfer or lease all or substantially all of our assets to any Person, or any corporation consolidates with or merges into or with us, in any such event pursuant to a transaction in which our outstanding Voting Stock is changed into or exchanged for cash, securities or other property, other than any such transaction where our outstanding Voting Stock is not changed or exchanged at all (except to the extent necessary to reflect a change in our jurisdiction of incorporation) or where (A) our outstanding Voting Stock is changed into or exchanged for (x) Voting Stock of the surviving corporation or (y) cash, securities and other property (other than Capital Stock of the surviving corporation) and (B) no person or group other than Permitted Holders owns immediately after such transaction, directly or indirectly, more than the greater of (1) 35% of the voting power of the total outstanding Voting Stock of the surviving corporation voting as one class and (2) the percentage of such voting power of the surviving corporation held, directly or indirectly, by Permitted Holders immediately after such transaction; or (iv) we are liquidated or dissolved or adopt a plan of liquidation or dissolution other than in a transaction which complies with the provisions described under Consolidation, Merger, Sale or Conveyance.

Consolidated Fixed Charge Coverage Ratio of us means, for any period, the ratio of (a) the sum of Consolidated Net Income (Loss), Consolidated Interest Expense, Consolidated Income Tax Expense and Consolidated Non-cash Charges deducted in computing Consolidated Net Income (Loss) in each case, for such period, of us and our Subsidiaries on a Consolidated basis, all determined in accordance with GAAP and on a pro forma basis for any acquisition or disposition of a Subsidiary or line of business following the first day of such period and on or prior to the date of determination as if all such acquisitions and dispositions had occurred on the first day of such period to (b) the sum of Consolidated Interest Expense for such period and cash dividends paid on any of our preferred stock and that of our Subsidiaries during such period; provided that (i) in making such computation, the Consolidated Interest Expense attributable to interest on any Funded Debt shall be computed on a pro forma basis for any incurrence or repayment of Funded Debt (other than Funded Debt under a revolving credit facility) following the first day of the applicable period and on or prior to the date of determination as if such incurrence or repayment had occurred on the first day of such period and Funded Debt (A) bearing a floating interest rate, shall be computed as if the rate in effect on the date of computation had been the applicable rate for the entire period and (B) which was not outstanding during the period for which the computation is being made but which bears, at our option, a fixed or floating rate of interest, shall be computed by applying at our option, either the fixed or floating rate and (ii) in making such computation, the Consolidated Interest Expense of

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the Company attributable to interest on any Funded Debt under a revolving credit facility computed on a pro forma basis shall be computed based upon the average daily balance of such Funded Debt during the applicable period.

Consolidated Income Tax Expense means for any period, as applied to us, the provision for federal, state, local and foreign income taxes of us and our Subsidiaries for such period as determined in accordance with GAAP on a Consolidated basis.

Consolidated Interest Expense of us means, without duplication, for any period, the sum of (a) our interest expense and that of our Subsidiaries for such period, on a Consolidated basis, including, without limitation, (i) amortization of debt discount, (ii) the net cost under interest rate contracts (including amortization of discounts), (iii) the interest portion of any deferred payment obligation and (iv) accrued interest, plus (b) (i) the interest component of the Capital Lease Obligations paid, accrued and/or scheduled to be paid or accrued by us and our Subsidiaries during such period and (ii) all our capitalized interest and that of our Subsidiaries, in each case as determined in accordance with GAAP on a Consolidated basis. Whenever pro forma effect is to be given to an acquisition or disposition of assets for the purpose of calculating the Consolidated Fixed Charge Coverage Ratio, the amount of Consolidated Interest Expense associated with any Funded Debt incurred in connection with such acquisition or disposition of assets shall be calculated on a pro forma basis in accordance with Regulation S-X under the Securities Act, as in effect on the date of such calculation.

Consolidated Net Income (Loss) of us means, for any period, the Consolidated net income (or loss) of us and our Subsidiaries for such period as determined in accordance with GAAP on a Consolidated basis, adjusted, to the extent included in calculating such net income (loss), by excluding, without duplication: (i) all extraordinary gains or losses (less all fees and expenses relating thereto); (ii) the portion of net income (or loss) of us and our Subsidiaries allocable to minority interests in unconsolidated Persons to the extent that cash dividends or distributions have not actually been received by us or one of our Subsidiaries; (iii) any gain or loss, net of taxes, realized upon the termination of any employee pension benefit plan; (iv) net gains (but not losses) (less all fees and expenses relating thereto) in respect of dispositions of assets other than in the ordinary course of business; or (v) the net income of any Subsidiary to the extent that the declaration of dividends or similar distributions by that Subsidiary of that income is not at the time permitted, directly or indirectly, by operation of the terms of its charter or any agreement, instrument, judgment, decree, order, statute, rule or governmental regulations applicable to that Subsidiary or its stockholders. Whenever pro forma effect is to be given to an acquisition or disposition of assets for the purpose of calculating the Consolidated Fixed Charge Coverage Ratio, the amount of income or earnings related to such assets shall be calculated on a pro forma basis in accordance with Regulation S-X under the Securities Act, as in effect on the date of such calculation.

Consolidated Net Tangible Assets means the aggregate amount of assets, reduced by applicable reserves and other properly deductible items, after deducting

- all current liabilities, excluding the current portion of any Funded Debt and any other current liabilities constituting Funded Debt because it is extendible or renewable, and

- all goodwill, trade names, trademarks, patents, unamortized debt discount and expense and other similar intangibles, all as set forth on our books and records and those of our Subsidiaries and computed in accordance with GAAP.

Consolidated Non-cash Charges of us means, for any period, the aggregate depreciation, amortization and other non-cash charges of us and our Subsidiaries for such period, as determined in accordance with GAAP on a Consolidated basis (excluding any non-cash charge which requires an accrual or reserve for cash charges for any future period).

Consolidation means, with respect to any Person, the consolidation of the accounts of such Person and each of its Subsidiaries if and to the extent the accounts of such Person and each of its Subsidiaries would normally be consolidated with those of such Person, all in accordance with GAAP. The term Consolidated shall have a similar meaning.

Funded Debt means all indebtedness for the repayment of money borrowed, whether or not evidenced by a bond, debenture, note or similar instrument or agreement, having a final maturity of more than 12 months after the date of its creation or having a final maturity of less than 12 months after the date of its creation but by its terms being renewable or extendible beyond 12 months after such date at the option of the borrower. When determining Funded Debt, indebtedness will not be included if, on or prior to the final maturity of that indebtedness, we have deposited the necessary funds for the payment, redemption or satisfaction of that indebtedness in trust with the proper depositary.

GAAP means generally accepted accounting principles in the United States, consistently applied, which are in effect on the date of the issuance of the notes. At any time after the date of issuance of the notes, we may elect to apply International Financial Reporting Standards (IFRS) accounting principles, consistently applied, as in effect at the time of such election, in lieu of GAAP and, from and after any such election, references herein to GAAP shall thereafter be construed to mean IFRS; provided that any such election, once made, shall be irrevocable; provided, further that any calculation or determination under the indenture that requires the application of GAAP for periods that include fiscal quarters ended prior to our election to apply IFRS shall remain as previously calculated or determined in accordance with GAAP. We must give notice of any election made in accordance with this definition to the Trustee and the holders of notes.

Permitted Holders means (a) Marilyn Sands, her descendants (whether by blood or adoption), her descendants spouses, her siblings, the descendants of her siblings (whether by blood or adoption), Hudson Ansley, Lindsay Caleo, William Caleo, Courtney Winslow, or Andrew Stern, or the estate of any of the foregoing Persons, or The Sands Family Foundation, Inc., (b) trusts which are for the benefit of any combination of the Persons described in clause (a), or any trust for the benefit of any such trust, or (c) partnerships, limited liability companies or any other entities which are controlled by any combination of the Persons described in clause (a), the estate of any such Persons, a trust referred to in the foregoing clause (b), or an entity that satisfies the conditions of this clause (c).

Person means any individual, corporation, limited liability company, partnership, joint venture, association, joint-stock company, trust, unincorporated organization, any other company or entity or government or any agency or political subdivision thereof.

Principal Property means, as of any date, any building, structure or other facility, together with the land upon which it is erected and any fixtures which are a part of the building, structure or other facility, used primarily for manufacturing, processing or production, in each case located in the United States, and owned or leased or to be owned or leased by us or any Subsidiary, and in each case the net book value of which as of that date exceeds 2% of our Consolidated Net Tangible Assets as shown on the consolidated balance sheet contained in our latest filing with the Securities and Exchange Commission, other than any such land, building, structure or other facility or portion thereof which is a pollution control facility, or which, in the opinion of our Board of Directors, is not of material importance to the total business conducted by us and our Subsidiaries, considered as one enterprise.

Property means any asset, revenue or any other property, whether tangible or intangible, real or personal, including, without limitation, any right to receive income.

Securities Act means the Securities Act of 1933, as amended, and the rules and regulations promulgated thereunder.

Subsidiary means any Person a majority of the equity ownership or the Voting Stock of which is at the time owned, directly or indirectly, by us or by one or more other Subsidiaries, or by us and one or more other Subsidiaries.

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Voting Stock means, with respect to any Person, Capital Stock of any class or kind the holders of which are ordinarily, in the absence of contingencies, entitled to vote for the election of directors (or persons performing similar functions) of such Person, even if the right so to vote has been suspended by the happening of such a contingency.

Global Notes; Book-Entry System

Global Notes

The notes will be issued initially in book-entry form and will be represented by one or more global notes in fully registered form without interest coupons which will be deposited with the trustee as custodian for The Depository Trust Company, which we refer to as DTC , and registered in the name of Cede & Co. (DTC s partnership nominee) or such other name as may be requested by an authorized representative of DTC. If, however, the aggregate principal amount of any issue exceeds $500.0 million, one certificate will be issued with respect to each $500.0 million of principal amount, and an additional certificate will be issued with respect to any remaining principal amount of such issue. The deposit of Securities with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual beneficial owners of the securities; DTC s records reflect only the identity of the direct participants to whose accounts such securities are credited, which may or may not be the beneficial owners. Direct and indirect participants will remain responsible for keeping account of their holdings on behalf of their customers. Except as set forth below, the global notes may be transferred, in whole and not in part, only to DTC or another nominee of DTC or to a successor of DTC or its nominee. Beneficial interests in the global notes may not be exchanged for certificated notes except in the limited circumstances described below.

All interests in the global notes will be subject to the rules and procedures of DTC.

Certain Book-Entry Procedures for the Global Notes

The descriptions of the operations and procedures of DTC set forth below are provided solely as a matter of convenience. These operations and procedures are solely within the control of DTC and are subject to change by DTC from time to time. Neither we nor the underwriters takes any responsibility for these operations or procedures, and investors are urged to contact DTC or its participants directly to discuss these matters.

DTC has advised us that it is:

- a limited-purpose trust company organized under the laws of the State of New York;
- a banking organization within the meaning of the New York Banking Law;
- a member of the Federal Reserve System;
- a clearing corporation within the meaning of the New York Uniform Commercial Code, as amended; and
- a clearing agency registered pursuant to Section 17A of the Exchange Act.

DTC was created to hold securities for its participants and to facilitate the clearance and settlement of securities transactions between participants through electronic book-entry changes to the accounts of its participants, thereby eliminating the need for physical transfer and delivery of securities certificates. DTC s participants include securities brokers and dealers (including one or more of the underwriters), banks and trust companies, clearing corporations and certain other organizations. Indirect access to DTC s system is also available to other entities such as banks, brokers, dealers and trust companies, which we refer to collectively as the indirect participants, that clear through or maintain a custodial relationship with a participant either directly or indirectly. Investors who are not participants may beneficially own securities held by or on behalf of DTC only through participants or indirect participants. DTC is a wholly-owned subsidiary of The Depository Trust &

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Clearing Corporation (DTCC). DTCC is the holding company for DTC, National Securities Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with participants or indirect participants.

We expect that, pursuant to procedures established by DTC:

- upon deposit of each global note, DTC will credit, on its book-entry registration and transfer system, the accounts of participants designated by the underwriters with an interest in the global note; and

- ownership of beneficial interests in the global notes will be shown on, and the transfer of ownership of beneficial interests in the global notes will be effected only through, records maintained by DTC (with respect to the interests of participants) and the participants and the indirect participants (with respect to the interests of persons other than participants).

The laws of some jurisdictions may require that some purchasers of securities take physical delivery of those securities in definitive form. Accordingly, the ability to transfer beneficial interests in the notes represented by a global note to those persons may be limited. In addition, because DTC can act only on behalf of its participants, who in turn act on behalf of persons who hold interests through participants, the ability of a person holding a beneficial interest in a global note to pledge or transfer that interest to persons or entities that do not participate in DTC s system, or to otherwise take actions in respect of that interest, may be affected by the lack of a physical security in respect of that interest.

So long as DTC or its nominee is the registered owner of a global note, DTC or that nominee, as the case may be, will be considered the sole legal owner or holder of the notes represented by that global note for all purposes of the notes and the indenture. Except as provided below, owners of beneficial interests in a global note will not be entitled to have the notes represented by that global note registered in their names, will not receive or be entitled to receive physical delivery of certificated notes and will not be considered the owners or holders of the notes represented by that beneficial interest under the indenture for any purpose, including with respect to the giving of any direction, instruction or approval to the trustee. Owners of beneficial interests in a global note will not receive written confirmation from DTC of their purchase. Owners of beneficial interests in a global note are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the direct or indirect participant through which the owner of beneficial interests in a global note entered into the transaction. Accordingly, each holder owning a beneficial interest in a global note must rely on the procedures of DTC and, if that holder is not a participant or an indirect participant, on the procedures of the participant through which that holder owns its interest, to exercise any rights of a holder of notes under the indenture or that global note. We understand that under existing industry practice, in the event that we request any action of holders of notes, or a holder that is an owner of a beneficial interest in a global note desires to take any action that DTC, as the holder of that global note, is entitled to take, DTC would authorize the participants to take that action and the participants would authorize holders owning through those participants to take that action or would otherwise act upon the instruction of those holders. Neither we nor the trustee will have any responsibility or liability for any aspect of the records relating to or payments made on account of notes by DTC or for maintaining, supervising or reviewing any records of DTC relating to the notes.

Payments with respect to the principal of and interest on a global note will be payable by the trustee to or at the direction of DTC or its nominee in its capacity as the registered holder of the global note under the indenture. Under the terms of the indenture, we and the trustee shall treat the persons in whose names the notes, including the global notes, are registered as the owners thereof for the purpose of receiving payment thereon and for any and all other purposes whatsoever. Accordingly, neither we nor the trustee has or will have any responsibility or liability for the payment of those amounts to owners of beneficial interests in a global note. Payments by the participants and the indirect participants to the owners of beneficial interests in a global note will be governed by standing instructions and customary industry practice and will be the responsibility of the participants and indirect participants and not of DTC.

Transfers between participants in DTC will be effected in accordance with DTC s procedures and will be settled in same-day funds.

Conveyance of notices and other communications by DTC to direct participants, by direct participants to indirect participants, and by direct participants and indirect participants to holders owning beneficial interests in a global note will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

Although DTC has agreed to the foregoing procedures to facilitate transfers of interests in the global notes among participants in DTC, it is under no obligation to perform or to continue to perform those procedures, and those procedures may be discontinued at any time. Neither we nor the trustee will have any responsibility for the performance by DTC or its participants or indirect participants of their respective obligations under the rules and procedures governing their operations.

We obtained the information in this section and elsewhere in this prospectus supplement concerning DTC and its book-entry system from sources that we believe are reliable, but we take no responsibility for the accuracy of any of this information.

Certificated Notes

We will issue certificated notes to each person that DTC identifies as the beneficial owner of the notes represented by the global securities upon surrender by DTC of the global securities only if:

- DTC notifies us that it is no longer willing or able to act as a depository for the global securities, and we have not appointed a successor depository within 90 days of that notice;

- we decide to discontinue use of the system of book-entry-only transfers through DTC (or a successor securities depository); or

- an event of default has occurred and is continuing and DTC so requests.

Neither we nor the trustee will be liable for any delay by DTC, its nominee or any direct or indirect participant in identifying the beneficial owners of the related notes. We and the trustee may conclusively rely on, and will be protected in relying on, instructions from DTC or its nominee for all purposes, including with respect to the registration and delivery, and the respective principal amounts, of the notes to be issued in certificated form.

Information Concerning the Trustee

Manufacturers and Traders Trust Company is the trustee under the indenture and will be the escrow agent under the Escrow Agreement. From time to time, we borrow from, maintain deposit accounts with and conduct other transactions with Manufacturers and Traders Trust Company and its affiliates in the ordinary course of business. In particular, Manufacturers and Traders Trust Company is currently a lender under our senior credit facility. Manufacturers and Traders Trust Company is a lender under a credit facility with a Sands family investment vehicle that, because of its relationship with members of the Sands family, is an affiliate of the Company. Such credit facility is secured by pledges of shares of our class B common stock.

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MATERIAL UNITED STATES FEDERAL INCOME TAX CONSIDERATIONS

The following discussion is a summary of material U.S. Federal income tax consequences of the acquisition, ownership and disposition of the notes and is based upon the provisions of the Internal Revenue Code of 1986, as amended, or the Code, the applicable Treasury Regulations promulgated and proposed thereunder, judicial authority and current administrative rulings and practice, all of which are subject to change, possibly with retroactive effect. The discussion does not purport to deal with all aspects of U.S. federal income taxation that might be relevant to particular holders in light of their personal investment circumstances or status, nor does it discuss the U.S. federal income tax consequences to holders subject to special treatment under the U.S. federal income tax laws (for example, financial institutions, insurance companies, dealers in securities, tax-exempt organizations, U.S. expatriates, persons subject to alternative minimum tax or taxpayers holding the notes through a partnership or similar pass-through entity or as part of a straddle, hedge or conversion transaction). Moreover, the effect of any applicable state, local or foreign tax laws and other federal tax laws (such as estate and gift tax and Medicare contribution tax laws) is not discussed.

This discussion assumes that the notes are held as capital assets (as defined in Section 1221 of the Code) by the holders thereof. The discussion is limited to the U.S. federal income tax consequences to holders acquiring notes at original issue for cash at the initial offering price.

PROSPECTIVE HOLDERS ARE URGED TO CONSULT THEIR OWN TAX ADVISORS REGARDING THE FEDERAL, STATE, LOCAL AND OTHER TAX CONSEQUENCES TO THEM OF THE ACQUISITION, OWNERSHIP AND DISPOSITION OF THE NOTES.

U.S. Holders

For purposes of the following discussion, the term U.S. Holder means a beneficial owner of a note who or which is, for U.S. federal income tax purposes:

- an individual who is a citizen or resident of the United States;
- a corporation (or other entity treated as a corporation for U.S. federal income tax purposes) created or organized under the laws of the United States, any state thereof or the District of Columbia;
- an estate the income of which is subject to U.S. federal income taxation regardless of its source; or
- a trust if a U.S. court is able to exercise primary supervision over the administration of the trust and one or more U.S. persons have the authority to control all substantial decisions of the trust, or if the trust has made a valid election to be treated as a United States person.

Interest on Notes

Interest on the notes generally will be included in income by a U.S. Holder as ordinary interest income when received or accrued in accordance with the U.S. Holder s regular method of accounting for U.S. federal income tax purposes.

Sale, Exchange, Redemption or Other Disposition of Notes

A sale, exchange, redemption or other disposition of a note will generally be a taxable event for U.S. federal income tax purposes. In such event, a U.S. Holder will recognize gain or loss equal to the difference between:

- the amount of cash plus the fair market value of any property received (except to the extent that amounts received are attributable to accrued interest, which portion of the consideration would be taxed as ordinary income to the extent not previously included in income); and the U.S. Holder s adjusted tax basis in the note, which will generally equal the price paid for the note.

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Such gain or loss will be capital gain or loss and will be long-term capital gain or loss if the note has been held for more than one year at the time of disposition. For non-corporate taxpayers, net long term capital gains are generally subject to tax at preferential rates. The deductibility of capital losses is subject to certain limitations.

Non-U.S. Holders

For purposes of the following discussion, the term non-U.S. Holder refers to a beneficial owner of a note that is for U.S. federal income tax purposes an individual, corporation, estate or trust that is not a U.S. Holder.

Interest on Notes

Interest paid to a non-U.S. Holder in respect of the notes that is not effectively connected with the non-U.S. Holder s trade or business in the United States generally will not be subject to withholding of U.S. federal income tax provided that:

- the non-U.S. Holder does not directly or indirectly, actually or constructively, own 10% or more of the total combined voting power of all classes of our voting stock;

- the beneficial owner is not a controlled foreign corporation with respect to which we are a related person within the meaning of the Code;

- the beneficial owner is not a bank receiving interest on an extension of credit made pursuant to a loan agreement in the ordinary course of its trade or business; and

- the non-U.S. Holder satisfies certain certification requirements. A beneficial owner will generally satisfy such certification requirements if it certifies, under penalties of perjury, that it is not a United States person and provides its name and address.

If the above conditions are not met, interest paid to a non-U.S. Holder in respect of the notes that is not effectively connected with the non-U.S. Holder s trade or business generally will be subject to 30% U.S. federal withholding tax unless such non-U.S. Holder is entitled to a reduction in or an exemption from such withholding under an applicable income tax treaty between the United States and the non-U.S. Holder s country of residence provided that such non-U.S. Holder satisfies certain certification requirements (generally, on a properly executed IRS Form W-8BEN).

If a non-U.S. Holder is engaged in a trade or business in the United States and interest on the notes is effectively connected with the conduct of that trade or business (and, if required by an applicable tax treaty, the interest is attributable to a permanent establishment or fixed base maintained by the non-U.S. Holder in the United States), the non-U.S. Holder will be subject to U.S. federal income tax on the interest on a net income basis in the same manner as if such non-U.S. Holder were a U.S. Holder. Any interest income that is effectively connected with the conduct of a U.S. trade or business will not be subject to withholding of U.S. federal income tax if the non-U.S. Holder satisfies certain certification requirements (generally, on a properly executed IRS Form W-8ECI or, in certain circumstances, W-8BEN). A non-U.S. Holder that is a foreign corporation that is engaged in a trade or business in the United States may also be subject to a 30% (or, if a tax treaty applies, such lower rate as the treaty provides) branch profits tax on its effectively connected earnings and profits.

Sale, Exchange, Redemption or Other Disposition of Notes

A non-U.S. Holder generally will not be subject to U.S. federal income tax on any gain recognized upon a sale, exchange, redemption or other disposition of a note unless:

- that gain is effectively connected with the non-U.S. Holder s conduct of a trade or business in the United States (and, if required by applicable tax treaty, the gain is attributable to a permanent establishment or fixed base maintained by the non-U.S. Holder in the United States); or the non-U.S. Holder is an individual who is present in the United States for 183 days or more in the taxable year of the disposition and certain other conditions are met.

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A non-U.S. Holder described in the first bullet point will be subject to U.S. federal income tax on the gain on a net income basis in the same manner as if such non-U.S. Holder were a U.S. Holder. If such non-U.S. Holder is a foreign corporation, it may also be subject to a 30% (or, if a tax treaty applies, such lower rate as the treaty provides) branch profits tax on its effectively connected earnings and profits. A non-U.S. Holder described in the second bullet point will be subject to 30% U.S. federal income tax on such gain unless an exemption or reduction under an applicable income tax treaty applies.

Backup Withholding and Information Reporting

Information returns may be filed with the IRS in connection with payments on the notes and the proceeds from a sale or other disposition (including a retirement or redemption) of the notes. A U.S. Holder may be subject to United States backup withholding tax at a rate of 28% on these payments if it fails to provide its taxpayer identification number to the paying agent and comply with certification procedures or otherwise establish an exemption from backup withholding.

A non-U.S. Holder may be subject to United States backup withholding tax on these payments unless the non-U.S. Holder complies with certification procedures to establish that it is not a U.S. person. The certification procedures required of non-U.S. Holders to claim the exemption from withholding tax on certain payments on the notes, described in general terms above, will satisfy the certification requirements necessary to avoid the backup withholding tax as well. The amount of any backup withholding from a payment will be allowed as a credit against the holder s U.S. federal income tax liability and may entitle the holder to a refund, provided that the required information is timely furnished to the IRS.

Foreign Account Tax Compliance Act

Legislation incorporating provisions referred to as the Foreign Account Tax Compliance Act (FATCA) was enacted on March 18, 2010. FATCA as initially enacted would apply to notes issued after March 18, 2012. However, recently issued proposed Treasury Regulations extended the grandfathering date and provided that FATCA generally would not apply to notes that are outstanding on January 1, 2013, although investors cannot rely on the proposed Treasury regulations until they become finalized.

If FATCA does apply to the notes, FATCA generally will impose a U.S. federal withholding tax of 30% on interest income on a note paid on or after January 1, 2014 and the gross proceeds from a disposition of a Note paid on or after January 1, 2015 to (i) a foreign financial institution (whether as a beneficial owner or an intermediary) if such institution fails to enter into an agreement with the United States government to collect and provide to the United States tax authorities substantial information regarding United States account holders of such institution (which may include certain equity and debt holders of such institution, as well as certain account holders that are foreign entities with United States owners) and (ii) a certain type of foreign entity that is not a financial institution (whether as a beneficial owner or an intermediary) if such entity fails to provide the withholding agent with a certification identifying the substantial United States owners of the entity, which generally includes any United States person who directly or indirectly owns more than 10 percent of the entity, unless an applicable exemption applies. Investors are encouraged to consult with their own tax advisors regarding the implications of FATCA on their investment in the notes.

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UNDERWRITING

Merrill Lynch, Pierce, Fenner & Smith Incorporated, J. P. Morgan Securities LLC, Rabo Securities USA, Inc., Barclays Capital Inc. and Wells Fargo Securities, LLC are acting as the joint book-running managers of the offering and Merrill Lynch, Pierce, Fenner & Smith Incorporated and J.P. Morgan Securities LLC are acting as representatives of the underwriters named below.

Subject to the terms and conditions stated in the underwriting agreement dated the date of this prospectus supplement, each underwriter named below has severally agreed to purchase, and we have agreed to sell to that underwriter, the principal amount of notes set forth opposite the underwriter s name.

Underwriter	Principal Amount
Merrill Lynch, Pierce, Fenner & Smith Incorporated	$ 203,125,000
J. P. Morgan Securities LLC	$ 203,125,000
Rabo Securities USA, Inc.	$ 97,500,000
Barclays Capital Inc.	$ 65,000,000
Wells Fargo Securities, LLC.	$ 48,750,000
HSBC Securities (USA) Inc.	$ 16,250,000
Mitsubishi UFJ Securities (USA), Inc.	$ 16,250,000
Total	$ 650,000,000

The underwriting agreement provides that the obligations of the underwriters to purchase the notes included in this offering are subject to approval of legal matters by counsel and to other conditions. The underwriters are obligated to purchase all the notes if they purchase any of the notes. The offering of the notes by the underwriters is subject to receipt and acceptance and subject to the underwriters right to reject any order in whole or in part. The underwriters may offer and sell notes through certain of their affiliates.

The underwriters propose to offer some of the notes directly to the public at the public offering price set forth on the cover page of this prospectus supplement and some of the notes to dealers at the public offering price less a concession. The underwriters may allow, and dealers may reallow, a concession on sales to other dealers. After the initial offering of the notes to the public, the representatives may change the public offering price and concessions.

We have agreed for a period of 60 days following the date of this prospectus supplement not to sell or announce an intention to sell any debt securities similar to the notes without the consent of Merrill Lynch, Pierce, Fenner & Smith Incorporated.

The notes are a new issue of securities with no established trading market. The notes will not be listed on any securities exchange. We have been advised by the underwriters that they intend to make a market in the notes, but the underwriters are not obligated to do so and may discontinue market making at any time without notice. We can give no assurance as to the liquidity of, or the trading market for, the notes.

In connection with the offering, the underwriters may purchase and sell notes in the open market. These transactions may include over-allotment, syndicate covering transactions and stabilizing transactions. Over-allotment involves syndicate sales of notes in excess of the principal amount of notes to be purchased by the underwriters in the offering, which creates a syndicate short position. Syndicate covering transactions involve purchases of the notes in the open market after the distribution has been completed in order to cover syndicate short positions. Stabilizing transactions consist of certain bids or purchases of notes made for the purpose of preventing or retarding a decline in the market price of the notes while the offering is in progress.

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The underwriters also may impose a penalty bid. Penalty bids permit the underwriters to reclaim a selling concession from a syndicate member when an underwriter, in covering syndicate short positions or making stabilizing purchases, repurchases notes originally sold by that syndicate member.

Any of these activities may have the effect of preventing or retarding a decline in the market price of the notes. They may also cause the price of the notes to be higher than the price that otherwise would exist in the open market in the absence of these transactions. The underwriters may conduct these transactions in the over-the-counter market or otherwise. If the underwriters commence any of these transactions, they may discontinue them at any time.

We estimate that our total expenses for this offering (including underwriting discounts) will be approximately $9.0 million.

The underwriters and their respective affiliates are full service financial institutions engaged in various activities, which may include securities trading, commercial and investment banking, financial advisory, investment management, investment research, principal investment, hedging, financing and brokerage activities.

The underwriters and their affiliates have performed and may in the future perform various investment banking, brokerage, commercial banking and advisory services for us from time to time for which they have received or will receive customary fees and expenses. In particular, affiliates of the underwriters are currently lenders under our senior credit facility. Additionally, affiliates of each of the underwriters have agreed to provide a portion of our unfunded $1.875 billion interim loan facility to finance the Crown Acquisition and, to the extent the proceeds of this offering are available to us on the closing date of the Crown Acquisition, they will correspondingly reduce the amount borrowed under such interim loan facility. See Prospectus Supplement Summary Recent Developments Financing Arrangements for the Crown Acquisition.

If any of the underwriters or their affiliates has a lending relationship with us, certain of those underwriters or their affiliates routinely hedge, and certain other of those underwriters or their affiliates may hedge, their credit exposure to us consistent with their customary risk management policies. Typically, these underwriters and their affiliates would hedge such exposure by entering into transactions which consist of either the purchase of credit default swaps or the creation of short positions in our securities, including potentially the notes offered hereby. Any such credit default swaps or short positions could adversely affect future trading prices of the notes offered hereby.

In the ordinary course of their various business activities, the underwriters and their respective affiliates may make or hold a broad array of investments and actively trade debt and equity securities (or related derivative securities) and financial instruments (including bank loans) for their own account and for the accounts of their customers, and such investment and securities activities may involve securities and/or instruments of the issuer (directly, as collateral securing other obligations or otherwise). The underwriters and their respective affiliates may also make investment recommendations and/or publish or express independent research views in respect of such securities or instruments and may at any time hold, or recommend to clients that they acquire, long and/or short positions in such securities and instruments.

Affiliates of certain of the underwriters are lenders under certain credit facilities with a Sands family investment vehicle that, because of its relationship with members of the Sands family, is an affiliate of the Company. Such credit facilities are secured by pledges of shares of our class A common stock, class B common stock or a combination thereof.

We have agreed to indemnify the several underwriters against certain liabilities, including liabilities under the Securities Act of 1933, or to contribute to payments the underwriters may be required to make because of any of those liabilities.

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We expect that delivery of the notes will be made to investors on or about August 14, 2012, which will be the sixth business day following the date of this offering memorandum (such settlement being referred to as T+6). Under Rule 15c6-1 under the Securities Exchange Act of 1934, trades in the secondary market are required to settle in three business days, unless the parties to any such trade expressly agree otherwise. Accordingly, purchasers who wish to trade notes on the date hereof or the next two succeeding business days will be required, by virtue of the fact that the notes initially settle in T+6, to specify an alternate settlement arrangement at the time of any such trade to prevent a failed settlement. Purchasers of the notes who wish to trade the notes prior to their date of delivery hereunder should consult their advisors.

Notice to Prospective Investors in the European Economic Area

In relation to each Member State of the European Economic Area which has implemented the Prospectus Directive (each, a Relevant Member State), with effect from and including the date on which the Prospectus Directive is implemented in that Relevant Member State (the Relevant Implementation Date) no offer of notes may be made to the public in that Relevant Member State other than:

A. to any legal entity which is a qualified investor as defined in the Prospectus Directive;

B. to fewer than 100 or, if the Relevant Member State has implemented the relevant provision of the 2010 PD Amending Directive, 150, natural or legal persons (other than qualified investors as defined in the Prospectus Directive), as permitted under the Prospectus Directive, subject to obtaining the prior consent of the representative(s); or

C. in any other circumstances falling within Article 3(2) of the Prospectus Directive;

provided, however, that no such offer of notes shall require the Company or the representative to publish a prospectus pursuant to Article 3 of the Prospectus Directive or supplement a prospectus pursuant to Article 16 of the Prospectus Directive.

This prospectus has been prepared on the basis that any offer of notes in any Relevant Member State will be made pursuant to an exemption under the Prospectus Directive from the requirement to publish a prospectus for offers of notes. Accordingly any person making or intending to make an offer in that Relevant Member State of notes which are the subject of the offering contemplated in this prospectus may only do so in circumstances in which no obligation arises for the Company or any of the underwriters to publish a prospectus pursuant to Article 3 of the Prospectus Directive in relation to such offer. Neither the Company nor the underwriters have authorized, nor do they authorize, the making of any offer of notes in circumstances in which an obligation arises for the Company or the underwriters to publish a prospectus for such offer.

For the purpose of the above provisions, the expression an offer to the public in relation to any notes in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the offer and the notes to be offered so as to enable an investor to decide to purchase or subscribe the notes, as the same may be varied in the Relevant Member State by any measure implementing the Prospectus Directive in the Relevant Member State and the expression Prospectus Directive means Directive 2003/71/EC (including the 2010 PD Amending Directive, to the extent implemented in the Relevant Member States) and includes any relevant implementing measure in the Relevant Member State and the expression 2010 PD Amending Directive means Directive 2010/73/EU.

Notice to Prospective Investors in the United Kingdom

In addition, in the United Kingdom, this document is being distributed only to, and is directed only at, and any offer subsequently made may only be directed at persons who are qualified investors (as defined in the Prospectus Directive) (i) who have professional experience in matters relating to investments falling within Article 19 (5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005, as amended (the Order) and/or (ii) who are high net worth companies (or persons to whom it may otherwise be lawfully communicated) falling within Article 49(2)(a) to (d) of the Order (all such persons together being referred to as relevant persons). This document must not be acted on or relied on in the United Kingdom by persons who are not relevant persons. In the United Kingdom, any investment or investment activity to which this document relates is only available to, and will be engaged in with, relevant persons.

Notice to Prospective Investors in Switzerland

This prospectus supplement does not constitute an issue prospectus pursuant to Article 652a or Article 1156 of the Swiss Code of Obligations and the notes will not be listed on the SIX Swiss Exchange. Therefore, this prospectus supplement may not comply with the disclosure standards of the listing rules (including any additional listing rules or prospectus schemes) of the SIX Swiss Exchange. Accordingly, the notes may not be offered to the public in or from Switzerland, but only to a selected and limited circle of investors who do not subscribe to the notes with a view to distribution. Any such investors will be individually approached by the underwriters from time to time.

Notice to Prospective Investors in the Dubai International Financial Centre

This prospectus supplement relates to an Exempt Offer in accordance with the Offered Securities Rules of the Dubai Financial Services Authority (DFSA). This prospectus supplement is intended for distribution only to persons of a type specified in the Offered Securities Rules of the DFSA. It must not be delivered to, or relied on by, any other person. The DFSA has no responsibility for reviewing or verifying any documents in connection with Exempt Offers. The DFSA has not approved this prospectus supplement nor taken steps to verify the information set forth herein and has no responsibility for the prospectus supplement. The notes to which this prospectus supplement relates may be illiquid and/or subject to restrictions on their resale. Prospective purchasers of the notes offered should conduct their own due diligence on the notes. If you do not understand the contents of this prospectus supplement you should consult an authorized financial advisor.

LEGAL MATTERS

The validity of our notes offered hereby will be passed upon for us by McDermott Will & Emery LLP. Certain legal matters in connection with the notes offered hereby will be passed upon for the underwriters by Cahill Gordon & Reindel LLP.

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PROSPECTUS

Constellation Brands, Inc.

Debt Securities, Preferred Stock, Depositary Shares

Representing Preferred Stock, Class A Common Stock,

Warrants, Stock Purchase Contracts and Stock Purchase Units

We may sell from time to time:

- our debt securities;
- shares of our preferred stock, which may be represented by depositary shares;
- shares of our Class A common stock;
- warrants;
- stock purchase contracts;
- stock purchase units; or
- any combination of the foregoing.

The debt securities may be guaranteed by our subsidiaries identified in this prospectus.

We will provide specific terms of the securities which we may offer in supplements to this prospectus or a term sheet. You should read this prospectus and any prospectus supplement or term sheet carefully before you invest. Securities may be sold for U.S. dollars, foreign currency or currency units.

Our Class A common stock is listed on the New York Stock Exchange under the symbol STZ .

Investing in our securities involves certain risks. See **Risk Factors on page 1 of this prospectus.**

We may offer and sell these securities to or through one or more underwriters, dealers or agents, or directly to investors, on a continuous or delayed basis.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this prospectus is August 6, 2012.

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ABOUT THIS PROSPECTUS

This prospectus is part of a registration statement on Form S-3 that we filed with the Securities and Exchange Commission using a shelf registration process. Under this process, we may sell any combination of the securities described in this prospectus in one or more offerings. This prospectus provides you with a general description of the securities we may offer. Each time we offer to sell securities, we will provide a supplement to this prospectus or a term sheet that will contain specific information about the terms of that offering. The prospectus supplement or term sheet may also add, update, or change information contained in this prospectus. You should read both this prospectus and any prospectus supplement or term sheet together with the additional information described under the heading Where You Can Find More Information, below.

WHERE YOU CAN FIND MORE INFORMATION

We file annual, quarterly and current reports, proxy statements and other information with the SEC. You may read and copy reports, statements or other information at the SEC s public reference room at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference rooms. Our SEC filings are also available to the public from commercial document retrieval services and at the website maintained by the SEC at http://www.sec.gov.

As noted above, we have filed with the SEC a registration statement on Form S-3 to register the securities. This prospectus is part of that registration statement and, as permitted by the SEC s rules, does not contain all the information set forth in the registration statement. For further information you may refer to the registration statement and to the exhibits and schedules filed as part of the registration statement. You can review and copy i

the registration statement and its exhibits and schedules at the public reference facilities maintained by the SEC as described above. The registration statement, including its exhibits and schedules, is also available on the SEC s website.

The SEC allows us to incorporate by reference the information we file with it, which means that we can disclose important information to you by referring you to certain of those documents. The information incorporated by reference is considered to be part of this prospectus, and the information that we file with the SEC after the date of this prospectus will automatically update and supersede this information. We incorporate by reference the documents listed below and any future filings we make with the SEC under Sections 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934, until we sell all of the securities:

Annual Report on Form 10-K for the fiscal year ended February 29, 2012 filed on April 30, 2012;

Quarterly Report on Form 10-Q for the fiscal quarter ended May 31, 2012 filed on July 10, 2012;

Current Reports on Form 8-K filed on April 5, 2012 (of the two reports filed on that date, only the one reporting information under Items 5.02 and 9.01); April 16, 2012; April 23, 2012; May 9, 2012; July 2, 2012 (Items 1.01, 2.03 and 9.01 only (but excluding Exhibit 99.1)); and July 31, 2012; and

The description of our class A common stock, par value $.01 per share, and class B common stock, par value $.01 per share, contained in Item 1 of our registration statement on Form 8-A filed on October 4, 1999.

You may request a copy of these filings, except exhibits to such documents unless those exhibits are specifically incorporated by reference into this prospectus, at no cost, by writing or telephoning us at: Constellation Brands, Inc., Attention: David S. Sorce, Secretary, 207 High Point Drive, Building 100, Victor, New York 14564; telephone number 585-678-7100.

You should rely only on the information incorporated by reference or provided in this prospectus or any prospectus supplement or term sheet. We have not authorized anyone else to provide you with different or additional information. You should not assume that the information in this prospectus or any prospectus supplement or term sheet is accurate as of any date other than the date on the front of those documents.

INFORMATION REGARDING FORWARD-LOOKING STATEMENTS

This prospectus, any prospectus supplement or term sheet, and the documents we have incorporated by reference into this prospectus may contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act. These forward-looking statements are subject to a number of risks and uncertainties, many of which are beyond our control, that could cause actual results to differ materially from those set forth in, or implied by, our forward-looking statements. All statements other than statements of historical facts included in this prospectus and elsewhere regarding our business strategy, future operations, financial position, estimated revenues, projected costs, prospects, plans and objectives of management, as well as information concerning expected actions of third parties, are forward-looking statements. These forward-looking statements are identifiable by our use of such words as anticipate, intend, estimate, expect, project and similar expressions, although not all forward-looking statements contain such identifying words. All forward-looking statements speak only as of the date on which we make them. We do not undertake any obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we can give no assurance that such expectations will prove to be correct. Important factors that could cause our actual results to differ materially from our expectations, or cautionary statements, are disclosed in this prospectus, any prospectus supplement or term sheet and the documents incorporated by reference, including the Risk Factors section included in our filings with the SEC. The cautionary statements qualify all forward-looking statements attributable to us or persons acting on our behalf.

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CONSTELLATION BRANDS, INC.

We are the world s leading premium wine company with a leading market position in both of our primary markets, which are the United States (U.S.) and Canada. Our wine portfolio is complemented by select premium spirits brands and other select beverage alcohol products. We are also the leading marketer of imported beer in the U.S. through our investment in Crown Imports LLC, a 50/50 joint venture with Grupo Modelo, S.A.B. de C.V., pursuant to which Grupo Modelo s Mexican beer portfolio is imported, marketed and sold by the joint venture in the U.S.

Since our founding in 1945 as a producer and marketer of wine products, we have grown through a combination of internal growth and acquisitions. Our internal growth has been driven by leveraging our existing portfolio of leading brands, developing new products, new packaging and line extensions, and focusing on the faster growing sectors of the beverage alcohol industry. We conduct our business through entities we wholly own as well as a variety of joint ventures with various other entities, both within and outside the U.S.

THE GUARANTORS

The guarantors of the debt securities may include the following companies, each of which is a direct or indirect subsidiary of Constellation Brands, Inc.: ALCOFI INC.; Constellation Beers Ltd.; Constellation Brands SMO, LLC; Constellation Brands U.S. Operations, Inc.; Constellation Leasing, LLC; Constellation Services LLC; Constellation Trading Company, Inc.; Franciscan Vineyards, Inc.; Robert Mondavi Investments; and The Hogue Cellars, Ltd. If so provided in a prospectus supplement or term sheet, each of the guarantors will guarantee on a joint and several basis our obligations under the debt securities, subject to certain limitations.

RISK FACTORS

Investing in our securities involves certain risks. You are urged to read and consider risk factors relating to an investment in our securities as described from time to time in our Annual Reports on Form 10-K, as may be updated from time to time in our Quarterly Reports on Form 10-Q filed with the SEC, each as incorporated by reference in this prospectus. Before making an investment decision, you should carefully consider these risks as well as other information we include or incorporate by reference in this prospectus. The risks and uncertainties we have described are not the only ones we face. The prospectus supplement applicable to each type or series of securities we offer will contain a discussion of additional risks applicable to an investment in us and the particular type of securities we are offering under that prospectus supplement.

USE OF PROCEEDS

Except as we may otherwise set forth in a prospectus supplement, we will use the net proceeds from the sale of the securities offered by this prospectus for general corporate purposes, including, but not limited to, repayment or refinancing of indebtedness, working capital, capital expenditures and acquisitions. Pending the application of the proceeds, we will invest the proceeds in certificates of deposit, U.S. government securities or other interest bearing securities.

DIVIDEND POLICY

We have not paid any cash dividends on our common stock since our initial public offering in 1973. We currently intend to retain all of our earnings to finance the development and expansion of our business, but may in the future consider paying cash dividends on our common stock. In addition, the terms of our senior credit facility may restrict the payment of cash dividends on our common stock under certain circumstances. Any indentures for debt securities issued in the future, the terms of any preferred stock issued in the future and any credit agreements entered into in the future may also restrict or prohibit the payment of cash dividends on our common stock.

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RATIO OF EARNINGS TO FIXED CHARGES

The following table sets forth our historical ratio of earnings to fixed charges for the periods indicated. For the purpose of calculating the ratio of earnings to fixed charges, earnings represent income (loss) before income taxes (adjusted, as appropriate, for equity in earnings of equity method investees) plus fixed charges less interest capitalized. Fixed charges consist of interest expensed and capitalized, amortization of debt issuance costs, amortization of discount on debt, and the portion of rental expense which management believes is representative of the interest component of lease expense.

	For the Three Months Ended May 31,		For the Fiscal Year Ended February 29,	For the Fiscal Years Ended February 28,			For the Fiscal Year Ended February 29,
	2012	2011	2012	2011	2010	2009	2008
Ratio of Earnings to Fixed Charges (1)	3.1x	3.5x	3.8x	3.6x	1.9x		

(1) For the years ended February 28, 2009 and February 29, 2008, earnings were inadequate to cover fixed charges. We would have needed to generate additional earnings of $110.5 million and $443.2 million for the year ended February 28, 2009 and February 29, 2008, respectively, to achieve a coverage ratio of 1.0 to 1.0 for these periods.

DESCRIPTION OF DEBT SECURITIES

We may offer debt securities under this prospectus, any of which may be issued as convertible or exchangeable debt securities. The following description of the terms of the debt securities sets forth certain general terms and provisions of the debt securities to which any prospectus supplement or term sheet may relate. We will set forth the particular terms of the debt securities we offer in a prospectus supplement or term sheet. The extent, if any, to which the following general provisions apply to particular debt securities will be described in the applicable prospectus supplement or term sheet. The following description of general terms relating to the debt securities and the indenture under which the debt securities will be issued are summaries only and therefore are not complete. You should read the indenture and the prospectus supplement or term sheet regarding any particular issuance of debt securities. If there are differences between the applicable prospectus supplement or term sheet and this prospectus, the prospectus supplement or term sheet will control.

The debt securities will represent our unsecured general obligations, unless otherwise provided in the prospectus supplement or term sheet. If so provided in a prospectus supplement or term sheet, the debt securities will have the benefit of the guarantees from the guarantors. Our subsidiaries are separate and distinct legal entities and have no obligation, contingent or otherwise, to pay any amounts due pursuant to the debt securities or to make any funds available therefor, whether by dividends, loans or other payments, other than as expressly provided in the guarantees.

Our ability to service our indebtedness, including the debt securities, is dependent primarily upon the receipt of funds from our subsidiaries. The payment of dividends or the making of loans and advances to us by our subsidiaries may be subject to contractual, statutory and regulatory restrictions, and are contingent upon the earnings of those subsidiaries and are subject to various business considerations. Further, any right we may have to receive assets of any of our subsidiaries upon liquidation or recapitalization of any such subsidiaries (and the consequent right of the holders of debt securities to participate in those assets) will be subject to the claims of our subsidiaries creditors. Even in the event that we are recognized as a creditor of a subsidiary, our claims would still be subject to any security interest in the assets of such subsidiary and any indebtedness of such subsidiary senior to our claim.

The debt securities will be issued under an indenture that will be entered into with the guarantors and the trustee. The indenture will be subject to, and governed by, the Trust Indenture Act of 1939.

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Except to the extent described in a prospectus supplement or term sheet, the indenture will not contain any covenants or restrictions that afford holders of the debt securities special protection in the event of a change of control or highly leveraged transaction.

The following is a summary of certain provisions of the debt securities that may be issued under the indenture, and is not complete. A description of such debt securities shall be contained in a prospectus supplement or term sheet. You should carefully read the provisions of particular debt securities we may issue and the indenture under which the debt securities are issued, including the definitions in those documents of certain terms and of those terms made a part of those documents by the Trust Indenture Act.

General

The indenture will not limit the aggregate principal amount of debt securities which may be issued under it and provides that debt securities may be issued in one or more series, in such form or forms, with such terms and up to the aggregate principal amount that we may authorize from time to time. The particular terms of the debt securities offered pursuant to any prospectus supplement or term sheet will be described in the prospectus supplement or term sheet. All debt securities of one series need not be issued at the same time and, unless otherwise provided, a series may be reopened, without the consent of any holder, for issuances of additional debt securities of that series.

Unless otherwise provided in the prospectus supplement or term sheet, debt securities may be presented for registration of transfer and exchange and for payment or, if applicable, for conversion or exchange at the office of the trustee.

The applicable prospectus supplement or term sheet will describe the following terms of any debt securities in respect of which this prospectus is being delivered (to the extent applicable to the debt securities):

(1) the title and designation of the debt securities of the series, and whether the debt securities are senior debt securities, senior subordinated debt securities or subordinated debt securities and, if senior subordinated or subordinated debt securities, the specific subordination provisions applicable thereto;

(2) the total principal amount of the debt securities of the series and any limit on the total principal amount;

(3) the price at which we will issue the debt securities of the series;

(4) the terms, if any, by which holders may convert the debt securities of the series into or for our common stock or other of our securities or property;

(5) if the debt securities of the series are convertible, any limitations on the ownership or transferability of the securities or property into which holders may convert the debt securities;

(6) the date or dates, or the method for determining the date or dates, on which we will be obligated to pay the principal of the debt securities of the series and the amount of principal we will be obligated to pay;

(7) the rate or rates, which may be fixed or variable, at which the debt securities of the series will bear interest, if any, or the method by which the rate or rates will be determined;

(8) the date or dates, or the method for determining the date or dates, from which any interest will accrue on the debt securities of the series, the dates on which we will be obligated to pay any such interest, the regular record dates, if any, for the determination of the persons to whom we will be obligated to pay such interest;

(9) the place or places where the principal of, and any premium, interest or other amounts payable (if any) on, the debt securities of the series will be payable or where the holders of the debt securities may surrender debt securities for conversion or transfer;

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(10) any provisions relating to the issuance of the debt securities at an original issue discount;

(11) the period or periods during which, the price or prices (including any premium or other amount) at which, the currency or currencies in which, and the other terms and conditions upon which, we may redeem the debt securities of the series, at our option, if we have such an option;

(12) our obligations (if any) to redeem, repay or purchase debt securities pursuant to any sinking fund or analogous provision or at the option of a holder of debt securities, and the price or prices at which, the period or periods within which and the terms and conditions upon which we will redeem, repay or purchase all or a portion of the debt securities of the series pursuant to that obligation;

(13) if other than denominations of $1,000 and any integral multiple thereof, the denominations in which the debt securities shall be issuable;

(14) any events of default in lieu of or in addition to those described in this prospectus and remedies relating to such events of default;

(15) if other than the trustee, the identity of each security registrar, transfer agent, paying agent or other agent for debt securities of the series;

(16) the currency or currencies in which we will sell the debt securities and in which principal of, and any premium, or interest or other amounts payable (if any) on, the debt securities of the series will be denominated and payable;

(17) whether the amount of payment of principal of, and any premium, or interest or other amounts payable (if any) on, the debt securities of the series may be determined with reference to an index, formula or other method and the manner in which the amounts will be determined;

(18) whether and under what circumstances we will pay any additional amounts on the debt securities to any holder who is not a U.S. person in respect of any tax, assessment or governmental charge withheld or deducted and, if we will pay additional amounts, whether we will have the option, and on what terms to redeem the debt securities instead of paying the additional amounts;

(19) if receipt of certain certificates or other documents or satisfaction of other conditions will be necessary for any purpose, including, without limitation, as a condition to the issuance of the debt securities in definitive form (whether upon original issue or upon exchange of a temporary debt security), the form and terms of such certificates, documents or conditions;

(20) any other affirmative or negative covenant included for the benefit of the debt securities of the series;

(21) whether the debt securities will be issued in whole or in part in the form of one or more global securities and, in such case, the depositary for such a global security and the circumstances under which any global security may be exchanged for debt securities registered in the name of, and under which any transfer of such global security may be registered in the name of, any person other than the depositary;

(22) whether the debt securities are defeasible;

(23) whether and the extent that the debt securities shall be guaranteed by the guarantors, the ranking of such guarantee, the terms of such subordination, if applicable, of any such guarantee and the form of any such guarantee;

(24) if other than the principal amount thereof, the portion of the principal amount of the debt securities of the series which shall be payable upon declaration of acceleration of the maturity thereof pursuant to an event of default or provable in bankruptcy, or, if applicable, which is convertible;

(25) any proposed listing of the debt securities of the series on any securities exchange; and

(26) any other specific terms of the debt securities.

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Unless otherwise indicated in the prospectus supplement or term sheet relating to the debt securities, principal of and any premium or interest on the debt securities will be payable, and the debt securities will be exchangeable and transfers thereof will be registrable, at the office of the trustee at its principal office. However, at our option, payment of interest may be made by check mailed to the address of the person entitled thereto as it appears in the debt security register. Any payment of principal and any premium or interest required to be made on an interest payment date, redemption date or at maturity which is not a business day need not be made on such date, but may be made on the next succeeding business day with the same force and effect as if made on the applicable date, and no interest shall accrue for the period from and after such date.

Unless otherwise indicated in the prospectus supplement or term sheet relating to debt securities, the debt securities will be issued only in fully registered form, without coupons, in denominations of $1,000 or any integral multiple thereof. No service charge will be made for any transfer or exchange of the debt securities, but we may require payment of a sum sufficient to cover any tax or other governmental charge payable in connection with a transfer or exchange.

Debt securities may be issued under the indenture for federal income tax purposes as Original Issue Discount Securities (as defined below). Federal income tax consequences and other special considerations applicable to any such Original Issue Discount Securities (or other debt securities treated as issued at an original issue discount) will be described in the prospectus supplement relating to such securities. Original Issue Discount Security generally means any debt security that (i) is issued at a price lower than its principal amount (subject to a de minimus exception), (ii) does not require the payment of interest in cash or property (other than debt instruments of the issuer) at least annually throughout the term of the debt security or (iii) is issuable in exchange for property (including other debt instruments) and does not provide for adequate stated interest.

Global Securities

The debt securities of a series may be issued in the form of one or more global securities that will be deposited with a depositary or its nominees identified in the prospectus supplement or term sheet relating to the debt securities. In such a case, one or more global securities will be issued in a denomination or aggregate denominations equal to the portion of the aggregate principal amount of outstanding debt securities of the series to be represented by such global security or securities.

No global security may be transferred except as a whole by a nominee of the depositary for such global security to the depositary or a nominee of the depositary and except in the circumstances described in the prospectus supplement or term sheet relating to the debt securities. The specific terms of the depositary arrangement with respect to a series of debt securities will be described in the prospectus supplement or term sheet relating to such series.

Guarantees

In order to enable us to obtain more favorable interest rates and terms of payment of principal of, premiums (if any), other amounts (if any) and interest on the debt securities, the debt securities may (if so specified in the prospectus supplement or term sheet) be guaranteed, jointly and severally, by all of the guarantors pursuant to guarantees. Guarantees will not be applicable to or guarantee our obligations with respect to the conversion of the debt securities into shares of our capital stock or other securities. Each guarantee will be an unsecured obligation of each guarantor issuing such guarantee unless otherwise provided in the prospectus supplement or term sheet. The ranking of a guarantee and the terms of the subordination, if any, will be set forth in the prospectus supplement or term sheet.

The indenture provides that, in the event any guarantee would constitute or result in a violation of any applicable fraudulent conveyance or similar law of any relevant jurisdiction, the liability of the guarantor under such guarantee will be reduced to the maximum amount (after giving effect to all other contingent and other liabilities of such guarantor) permissible under the applicable fraudulent conveyance or similar law.

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Consolidation, Merger, Sale or Conveyance

The indenture provides that we may consolidate with, or sell, convey or lease all or substantially all of our assets to, or merge with or into, any other corporation, if:

- either we are the continuing corporation, or the successor corporation expressly assumes the due and punctual payment of the principal of and interest on all the debt securities outstanding under the indenture according to their tenor and the due and punctual performance and observance of all of the covenants and conditions of the indenture to be performed or observed by us; and

- immediately after the merger or consolidation, or the sale, conveyance or lease, no event of default, and no event which, after notice or lapse of time or both, would become an event of default, shall have occurred and be continuing.

Modification of the Indenture

We and the trustee may modify the indenture with respect to the debt securities of any series, with or without the consent of the holders of debt securities, under certain circumstances to be described in a prospectus supplement or term sheet.

Satisfaction and Discharge of Indenture

We may terminate our obligations under the debt securities of any series, except for certain limited surviving obligations, if either all of the debt securities of such series have been delivered to the trustee for cancellation or the debt securities of such series mature within one year or may be called for redemption within one year and, among other things, we deposit with the trustee cash or appropriate government obligations sufficient for the payment of principal and interest on the debt securities of such series to maturity.

Defaults and Notice

The debt securities will contain events of default to be specified in the applicable prospectus supplement or term sheet, including, without limitation:

- failure to pay the principal of, or premium, if any, on any debt security of such series when due and payable (whether at maturity, by call for redemption, through any mandatory sinking fund, by redemption at the option of the holder, by declaration of acceleration or otherwise);

- failure to make a payment of any interest on any debt security of such series when due and payable, which failure shall have continued for a period of 30 days;

- our, or any guarantor s, failure to perform or observe any other covenants or agreements in the indenture or in the debt securities of such series which failure shall have continued for a period of at least 90 days after written notice to us or the guarantors, as the case may be, by the trustee or to us and the trustee from the holders of not less than 25% of the aggregate principal amount of the then outstanding debt securities of such series;

- certain events of bankruptcy, insolvency or reorganization of us; and

- any guarantee of a guarantor that is a significant subsidiary in respect of such series of debt securities shall for any reason cease to be, or be asserted in writing by any guarantor thereof or us not to be, in full force and effect, and enforceable in accordance with its terms subject to certain exceptions.

If an event of default with respect to debt securities of any series shall occur and be continuing, the trustee or the holders of not less than 25% in aggregate principal amount of the then outstanding debt securities of such series may declare the principal amount (or, if the debt securities of such series are issued at an original issue discount, such portion of the principal amount as may be specified in the terms of the debt securities of such series) of all debt securities of such series or such other amount or amounts as the debt securities or supplemental indenture with respect to such series may provide, to be due and payable immediately.

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The indenture will provide that, at any time after a declaration of acceleration with respect to the debt securities of any series as described in the preceding paragraph, the holders of a majority in principal amount of the then outstanding debt securities of such series may rescind and cancel such declaration and its consequences:

(1) if the rescission would not conflict with any judgment or decree;

(2) if all existing events of default with respect to the debt securities of such series have been cured or waived except nonpayment of principal or interest that has become due solely because of the acceleration;

(3) to the extent the payment of such interest is lawful, if interest on overdue installments of interest and overdue principal, which has become due otherwise than by such declaration of acceleration, has been paid; and

(4) if the Company has paid the trustee its reasonable compensation and reimbursed the trustee for its expenses, disbursements and advances.

No such rescission shall affect any subsequent default or event of default or impair any right consequent thereto.

The indenture provides that the trustee will, within 90 days after the occurrence of a default, give to holders of debt securities of any series notice of all uncured defaults with respect to such series known to it. However, in the case of a default that results from the failure to make any payment of the principal of, premium, if any, or interest on the debt securities of any series, or in the payment of any mandatory sinking fund installment with respect to debt securities of such series, the trustee may withhold such notice if it in good faith determines that the withholding of such notice is in the interest of the holders of debt securities of such series.

The indenture contains a provision entitling the trustee to be offered reasonable indemnity by holders of debt securities before proceeding to exercise any trust or power under the indenture at the request of such holders. The indenture provides that the holders of a majority in aggregate principal amount of the then outstanding debt securities of any series may direct the time, method and place of conducting any proceedings for any remedy available to the trustee, or of exercising any trust or power conferred upon the trustee with respect to the debt securities of such series. However, the trustee may decline to follow any such direction if, among other reasons, the trustee determines in good faith that the actions or proceedings as directed, would involve the trustee in personal liability or would be unduly prejudicial to the holders of the debt securities of such series not joining in such direction.

The right of a holder of debt securities of any series to institute a proceeding with respect to the indenture is subject to certain conditions including that the holders of at least 25% in aggregate principal amount of the debt securities of such series then outstanding make a written request upon the trustee to exercise its power under the indenture, offer reasonable indemnity to the trustee and afford the trustee reasonable opportunity to act. Even so, the holder has an absolute right to receipt of the principal of, premium, if any, and interest when due, to require conversion of debt securities if the indenture provides for convertibility at the option of the holder and to institute suit for the enforcement of such rights.

Concerning the Trustee

The prospectus supplement or term sheet with respect to particular debt securities will describe any relationship that we may have with the trustee for such debt securities.

Reports to Holders of Debt Securities

We intend to furnish to holders of debt securities all quarterly and annual reports that we furnish to holders of our common stock, and file such additional information, documents and reports as may be required by the rules and regulations prescribed from time to time by the Securities and Exchange Commission.

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DESCRIPTION OF PREFERRED STOCK

Our board of directors is authorized to issue in one or more series, generally without stockholder approval, up to 1,000,000 shares of preferred stock, par value $.01 per share. Undesignated shares of preferred stock can be issued with such designations, preferences, qualifications, privileges, limitations, restrictions, options, voting powers (full or limited), conversion or exchange rights and other special or relative rights as the board of directors shall from time to time fix by resolution. Thus, unless a specific stockholder approval requirement applies and subject to any statutory or contractual or other limitations as to class rights or other matters that might apply, our board of directors could authorize the issuance of preferred stock with voting, conversion and other rights that could dilute the voting power and other rights of holders of our common stock. The prospectus supplement or term sheet relating to a series of preferred stock will set forth the dividend, voting, conversion, exchange, repurchase and redemption rights, if applicable, the liquidation preference, and other specific terms of such series of preferred stock.

The description of certain provisions of the preferred stock set forth in any prospectus supplement or term sheet does not purport to be complete and is subject to and qualified in its entirety by reference to our certificate of incorporation and the certificate of designations relating to each series of preferred stock. The applicable prospectus supplement or term sheet will describe the specific terms of any series of preferred stock being offered which may include:

- the specific designation, number of shares, seniority and purchase price;
- any liquidation preference per share;
- any date of maturity;
- any redemption, repayment or sinking fund provisions;
- any dividend rate or rates and the dates on which any such dividends will be payable (or the method by which such rates or dates will be determined);
- any voting rights;
- if other than the currency of the United States, the currency or currencies (including composite currencies) in which such preferred stock is denominated and in which payments will or may be payable;
- the method by which amounts in respect of such series of preferred stock may be calculated and any commodities, currencies or indices, or value, rate or price, relevant to such calculation;
- whether such series of preferred stock is convertible or exchangeable and, if so, the securities or rights into which it is convertible or exchangeable, and the terms and conditions upon which such conversions or exchanges will be effected;
- the place or places where dividends and other payments on such series of preferred stock will be payable; and
- any additional voting, dividend, liquidation, redemption and other rights, preferences, privileges, limitations and restrictions.

As described under Description of Depositary Shares below, we may, at our option, elect to offer depositary shares evidenced by depositary receipts, each representing an interest (to be specified in the prospectus supplement or term sheet relating to the particular series of preferred stock) in a share of the particular series of preferred stock issued and deposited with a depositary.

All shares of preferred stock offered by this prospectus, or issuable upon conversion, exchange or exercise of securities, will, when issued, be validly issued and fully paid and non-assessable.

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DESCRIPTION OF DEPOSITARY SHARES

We may offer fractional shares of preferred stock rather than full shares of preferred stock, and, in that event, will issue receipts for depositary shares. Each of these depositary shares will represent a fraction, which will be set forth in the applicable prospectus supplement or term sheet, of a share of the applicable series of preferred stock. The shares of any series of preferred stock underlying any depositary shares that we may sell under this prospectus will be deposited under a deposit agreement between us and a depositary selected by us. Subject to the terms of the deposit agreement, each holder of a depositary share will be entitled, in proportion to the applicable fraction of a share of the preferred stock underlying the depositary share, to all of the rights, preferences and privileges, and be subject to the qualifications and restrictions, of the preferred stock underlying that depositary share. The description set forth below and in any prospectus supplement or term sheet of certain provisions of the deposit agreement and of the depositary shares and depositary receipts is not complete. You should carefully review the prospectus supplement or term sheet and the form of deposit agreement and form of depositary receipts relating to each series of preferred stock.

General

We may, at our option, elect to have shares of any series of preferred stock be represented by depositary shares. The shares of any series of preferred stock underlying the depositary shares will be deposited under a separate deposit agreement that we will enter with a bank or trust company having its principal office in the United States and a combined capital and surplus of at least $50,000,000. This bank or trust company will be considered the depositary. The prospectus supplement or term sheet relating to a series of depositary shares will set forth the name and address of the depositary. Subject to the terms of the deposit agreement, each owner of a depositary share will be entitled, in proportion to the applicable interest in the number of shares of such series of preferred stock underlying such depositary share, to all the rights and preferences of such series of preferred stock underlying such depositary share (including dividend, voting, redemption, conversion, exchange and liquidation rights).

The depositary shares will be evidenced by depositary receipts issued pursuant to the deposit agreement, each of which will represent the applicable interest in a number of shares of such series of preferred stock described in the applicable prospectus supplement or term sheet.

Unless otherwise specified in the prospectus supplement or term sheet, a holder of depositary shares is not entitled to receive the shares of such series of preferred stock underlying the depositary shares.

Pending the preparation of definitive depositary receipts, the depositary may, upon our written order, issue temporary depositary receipts substantially identical to the definitive depositary receipts. Definitive depositary receipts will thereafter be prepared without unreasonable delay.

Dividends and Other Distributions

The depositary will distribute all cash dividends or other cash distributions received in respect of the applicable series of preferred stock to the record holders of depositary shares representing such preferred stock in proportion to the numbers of depositary shares owned by the holders on the relevant record date.

In the event of a distribution other than in cash, the depositary will distribute property received by it to the record holders of depositary shares entitled to such property, as nearly as practicable, in proportion to the number of depositary shares owned by the holder. However, if the depositary determines that it is not feasible to make such distribution, it may, with our approval, sell such property and distribute the net proceeds from such sale to the holders. The amounts distributed by the depositary may be reduced by any amount required to be withheld by us or the depositary on account of taxes.

The deposit agreement will also contain provisions relating to the manner in which any subscription or similar rights we offer to holders of preferred stock shall be made available to holders of depositary shares.

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Conversion and Exchange

If any preferred stock underlying the depositary shares is subject to provisions relating to its conversion or exchange as set forth in the prospectus supplement or term sheet relating thereto, each record holder of depositary shares will have the right or obligation to convert or exchange such depositary shares pursuant to its terms.

Redemption of Depositary Shares

If a series of preferred stock underlying the depositary shares is subject to redemption, the depositary shares will be redeemed from the proceeds received by the depositary resulting from the redemption, in whole or in part, of the series of preferred stock held by the depositary. The redemption price per depositary share will be equal to the aggregate redemption price payable with respect to the number of shares of such series of preferred stock underlying the depositary shares. Whenever we redeem a series of preferred stock from the depositary, the depositary will redeem as of the same redemption date a proportionate number of depositary shares representing the shares of such series of preferred stock that were redeemed. If less than all the depositary shares are to be redeemed, the depositary shares to be redeemed will be selected by lot or pro rata as we may determine.

After the date fixed for redemption, the depositary shares so called for redemption will no longer be deemed to be outstanding and all rights of the holders of the depositary shares will cease, except the right to receive the redemption price payable upon such redemption.

Voting

Upon receipt of notice of any meeting or action in lieu of any meeting at which the holders of any shares of a series of preferred stock underlying the depositary shares are entitled to vote, the depositary will mail the information contained in such notice to the record holders of the depositary shares relating to such shares of preferred stock. Each record holder of such depositary shares on the record date (which will be the same date as the record date for such series of preferred stock) will be entitled to instruct the depositary as to the exercise of the voting rights pertaining to the number of shares of such series of preferred stock underlying such holder s depositary shares. The depositary will endeavor, as practicable, to vote the number of shares of such series of preferred stock underlying such depositary shares in accordance with such instructions, and we will agree to take all action which may be deemed necessary by the depositary in order to enable the depositary to do so. If the depositary does not receive instructions from the holders of depositary shares, the depositary will abstain from voting the preferred stock that underlies these depositary shares.

Amendment of the Deposit Agreement

The form of depositary receipt evidencing the depositary shares and any provision of the deposit agreement may at any time be amended by agreement between us and the depositary. However, any amendment which materially and adversely alters the rights of the existing holders of depositary shares will not be effective unless such amendment has been approved by the holders of at least a majority of the depositary shares then outstanding.

Charges of Depositary

We will pay all transfer and other taxes and governmental charges that arise solely from the existence of the depositary arrangements. We will pay charges of the depositary in connection with the initial deposit of the applicable series of preferred stock and any exchange or redemption of such series of preferred stock. Holders of depositary shares will pay all other transfer and other taxes and governmental charges, and, in addition, such other charges as are expressly provided in the deposit agreement to be for their accounts.

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Miscellaneous

We, or at our option, the depositary, will forward to the holders of depositary shares all of our reports and communications which we are required to furnish to the holders of the series preferred stock represented by the depository receipts.

Neither we nor the depositary will be liable if we or the depositary is prevented or delayed by law or any circumstances beyond our or its control in performing our or its obligations under the deposit agreement. Our obligations and the depositary s obligations under the deposit agreement will be limited to performance in good faith and neither we nor the depositary will be obligated to prosecute or defend any legal proceeding in respect of any depositary share or preferred stock unless satisfactory indemnity has been furnished. Both we and the depositary may rely upon written advice of counsel or accountants, or information provided by persons presenting preferred stock for deposit, holders of depositary shares or other persons believed to be competent and on documents believed to be genuine.

Resignation and Removal of Depositary; Termination of the Deposit Agreement

The depositary may resign at any time by delivering notice to us of its election to do so, and we may at any time remove the depositary. Any such resignation or removal will take effect upon the appointment of a successor depositary and its acceptance of such appointment. We will appoint a successor depositary within 60 days after delivery of the notice of resignation or removal. We may terminate the deposit agreement or it may be terminated by the depositary if a period of 90 days expires after the depositary has delivered written notice to us of its election to resign and we have not appointed a successor depositary. Upon termination of the deposit agreement, the depositary will discontinue the transfer of depositary receipts, will suspend the distribution of dividends to the holders of depositary receipts, and will not give any further notices (other than notice of such termination) or perform any further acts under the deposit agreement except that the depositary will continue to deliver the applicable series of preferred stock certificates, together with dividends and distributions and the net proceeds of any sales of rights, preferences, privileges or other property in exchange for depositary receipts surrendered. Upon our request, the depositary will deliver to us all books, records, certificates evidencing the applicable series of preferred stock, depositary receipts and other documents relating to the subject matter of the deposit agreement.

DESCRIPTION OF COMMON STOCK

If we offer shares of Class A common stock, the prospectus supplement or term sheet will set forth the number of shares offered, the public offering price, information regarding our dividend history and Class A common stock prices as reflected on the New York Stock Exchange or other exchange that the Class A common stock is then listed, including a recent reported last sale price of the Class A common stock. Our authorized common stock currently consists of 377,000,000 shares, of which 322,000,000 shares are Class A common stock, par value $.01 per share, 30,000,000 shares are Class B common stock, par value $.01 per share and 25,000,000 shares are Class 1 common stock, $.01 par value per share.

The shares of Class A common stock offered by this prospectus will, when issued, be validly issued and fully paid and non-assessable, not subject to redemption and without preemptive or other rights to subscribe for or purchase any proportionate part of any new or additional issues of stock of any class or of securities convertible into stock of any class.

The following descriptions of our common stock and certain provisions of our Restated Certificate of Incorporation, as amended, and By-Laws, as amended and restated, are summaries and are not complete. You should carefully review the provisions of our Restated Certificate of Incorporation, as amended, and By-Laws, as amended and restated, and appropriate provisions of the Delaware General Corporation Law.

General

The rights of holders of Class A common stock and Class B common stock are identical except for voting, dividends and conversion rights. The rights of holders of Class 1 common stock are generally comparable to the rights of holders of Class B common stock except that shares of Class 1 common stock do not generally have voting rights and the circumstances under which shares of Class 1 common stock are convertible into shares of Class A common stock are limited.

Voting

Except as described below in connection with the election of directors and except where a separate class vote is required under Delaware law, the holders of Class A common stock and Class B common stock vote together as a single class on all matters submitted to a vote of the stockholders. In the instances in which the holders of Class A common stock and Class B common stock vote together as a single class, the holders of Class A common stock are entitled to one vote per share and the holders of Class B common stock are entitled to 10 votes per share. Alternatively, in instances where the holders of Class A common stock and Class B common stock vote as separate classes, holders of both the Class A common stock and Class B common stock are entitled to one vote per share.

With respect to the election of directors at a meeting of stockholders, holders of Class A common stock, voting as a separate class, are entitled to elect one-fourth of the members of our board of directors (rounded up, if necessary, to the nearest whole number of directors). If the number of outstanding shares of Class B common stock is an amount equal to or greater than $12^1/_2$% of the aggregate number of outstanding shares of Class A common stock and Class B common stock, the holders of Class B common stock, voting as a separate class, are entitled to elect the remaining directors; otherwise, the holders of Class A common stock and Class B common stock, voting together as a single class, are entitled to elect the remaining directors (in which case the holders of Class A common stock are entitled to one vote per share and the holders of Class B common stock are entitled to 10 votes per share).

Holders of Class 1 common stock are not entitled to vote except that such holders are entitled to vote as a separate class on matters with respect to which a separate class vote of holders of Class 1 common stock is required by law and are entitled to vote with respect to any increase or decrease in the authorized number of shares of Class 1 common stock as a single class with the holders of Class A common stock and Class B common stock (in which case the holders of Class 1 common stock and Class A common stock are entitled to one vote per share and the holders of Class B common stock are entitled to ten votes per share).

Dividends

If we declare and pay a cash dividend on Class B common stock, we must declare and pay a cash dividend on Class 1 common stock in the same amount per share, and if we declare and pay a cash dividend on Class 1 common stock, we must declare and pay a cash dividend on Class B common stock in the same amount per share. In addition, if we pay a cash dividend on Class B common stock and Class 1 common stock, each share of Class A common stock will receive a cash dividend in an amount at least 10% greater than the amount of the cash dividend per share paid on Class B common stock and Class 1 common stock. Our board of directors may declare and pay a dividend on Class A common stock without paying any dividend on Class B common stock or Class 1 common stock. Our senior credit facility may restrict the payment of cash dividends on our common stock under certain circumstances. Any indentures for debt securities issued in the future, the terms of any preferred stock issued in the future and any credit agreements entered into in the future may also restrict or prohibit the payment of cash dividends on our common stock.

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Conversion

Each share of Class B common stock is convertible into one fully paid and non-assessable share of Class A common stock at the option of the holder at any time. The shares of Class A common stock are not convertible into or exchangeable for shares of Class B common stock or any of our other securities. Each holder of a share of Class 1 common stock may convert shares of Class 1 common stock into shares of Class A common stock on a one-for-one basis; provided such conversion is permitted only if the holder immediately sells the Class A common stock acquired upon conversion in a market transaction or to an unrelated party in a bona fide private sale. The Company does not intend to list the Class 1 common stock on the New York Stock Exchange or any other exchange. A holder wishing to sell shares of Class 1 common stock may convert such shares of Class 1 common stock into shares of Class A common stock (which are currently listed on the New York Stock Exchange) immediately prior to a qualifying sale of the shares. The terms of the Class 1 common stock do not impose any transfer restrictions on shares of Class 1 common stock; however, shares of Class 1 common stock may be subject to restrictions on transfer imposed by applicable securities laws.

Other Provisions

Holders of Class A common stock, Class B common stock and Class 1 common stock are entitled to share pro rata in the distribution of our assets available for such purpose in the event of our liquidation, dissolution or winding up, after payment of, or provision for, creditors and distribution of, or provision for, preferential amounts and unpaid accumulated dividends to holders of preferred stock, if any. Holders of Class A common stock, Class B common stock and Class 1 common stock have no preemptive rights to subscribe for any additional securities of any class which we may issue, and there are no redemption provisions or sinking fund provisions applicable to any such classes, nor is the Class A common stock, Class B common stock and Class 1 common stock subject to calls or assessments.

Certain Statutory Provisions

We are subject to Section 203 of the Delaware General Corporation Law. Section 203 prohibits a publicly held Delaware corporation from engaging in any business combination with any interested stockholder for a period of three years following the time that such person became an interested stockholder, unless

prior to the time the interested stockholder becomes an interested stockholder, the board of directors approved either the business combination or the transaction which resulted in the stockholder becoming an interested stockholder;

upon consummation of the transaction which resulted in the stockholder becoming an interested stockholder, the interested stockholder owns at least 85% of the outstanding voting stock; or

at or subsequent to the time the interested stockholder became an interested stockholder, the business combination is approved by the board of directors and authorized at a meeting of the corporation s stockholders by the affirmative vote of at least $66\frac{2}{3}$% of the outstanding voting stock that is not owned by the interested stockholder.

For purposes of Section 203, a business combination includes a merger, assets sale or other transaction resulting in a financial benefit to the interested stockholder, and an interested stockholder is a person who, together with affiliates and associates, owns (or within three years, did own) 15% or more of the corporation s voting stock.

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DESCRIPTION OF WARRANTS

The following is a general description of the terms of the warrants we may issue from time to time. Particular terms of any warrants we offer will be described in the prospectus supplement or term sheet relating to such warrants.

General

We may issue warrants to purchase our Class A common stock, preferred stock, depositary shares, debt securities or any combination thereof. Warrants may be issued independently or together with other securities and may be attached to or separate from those securities. The warrants will be issued under warrant agreements to be entered into between us and a warrant agent. The warrant agent will act solely as our agent and will not assume any obligation or relationship of agency for or with holders or beneficial owners of warrants.

The particular terms of each issue of warrants, the warrant agreement relating to the warrants and the warrant certificates representing warrants will be described in the applicable prospectus supplement or term sheet. This description will include:

- the title of the warrants;
- the price or prices at which the warrants will be issued, if any;
- the designation and terms of the Class A common stock, preferred stock, depositary shares or debt securities for which the warrants are exercisable;
- if applicable, the designation and terms of the other securities with which the warrants are issued, and the number of warrants issued with each share or unit of such other securities;
- the currency or currencies, including composite currencies, in which the price of such warrants may be payable;
- if applicable, the date on and after which the warrants and the other securities will be separately transferable;
- the number of shares of Class A common stock, preferred stock, depositary shares or the principal amount of debt securities that may be purchased upon exercise of a warrant and the price at which the shares or debt securities may be purchased upon exercise;
- anti-dilution provisions of the warrants, if any;
- with respect to debt securities only, whether the warrants represented by the warrant certificates or debt securities that may be issued upon exercise of the warrants will be issued in registered or bearer form;
- if applicable, a discussion of any material federal income tax considerations; and
- any other terms of the warrants, including terms, procedures and limitations relating to the exchange and exercise of the warrants.

Modifications

The warrant agreement may be amended by us and the warrant agent, without the consent of the holder of any warrant certificate, for the purpose of curing any ambiguity, or of curing, correcting or supplementing any defective provision contained in the warrant agreement, or making any provisions in regard to matters or questions arising under the warrant agreement that we may deem necessary or desirable; provided, that the amendment may not adversely affect the interest of the holders of warrant certificates in any material respect.

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DESCRIPTION OF STOCK PURCHASE CONTRACTS AND STOCK PURCHASE UNITS

The following is a general description of the terms of the stock purchase contracts and stock purchase units we may issue from time to time. Particular terms of any stock purchase contracts and/or stock purchase units we offer will be described in the prospectus supplement or term sheet relating to such stock purchase contracts and/or stock purchase units.

We may issue stock purchase contracts, representing contracts obligating holders to purchase from us, and we may sell to the holders, a specified number of shares of Class A common stock, preferred stock or depositary shares at a future date or dates. The price per share of Class A common stock, preferred stock or depositary shares may be fixed at the time the stock purchase contracts are issued or may be determined by reference to a specific formula set forth in the stock purchase contracts. Any stock purchase contract may include anti-dilution provisions to adjust the number of shares issuable pursuant to such stock purchase contract upon the occurrence of certain events.

Stock purchase contracts may be issued separately or as a part of units (stock purchase units) consisting of a stock purchase contract and our debt securities or debt obligations of third parties, including U.S. Treasury securities, in each case securing holders obligations to purchase Class A common stock, preferred stock or depositary shares under the stock purchase contracts. The stock purchase contracts may require us to make periodic payments to the holders of the stock purchase units or vice versa, and such payments may be unsecured or prefunded on some basis. The stock purchase contracts may require holders to secure their obligations thereunder in a specified manner.

The applicable prospectus supplement or term sheet will describe the terms of any stock purchase contracts or stock purchase units. Certain material federal income tax considerations applicable to the stock purchase units and stock purchase contracts will be set forth in the prospectus supplement or term sheet relating thereto.

PLAN OF DISTRIBUTION

We may sell securities pursuant to this prospectus in any of four ways:

- directly to purchasers;
- through agents;
- through dealers; or
- through one or more underwriters or a syndicate of underwriters in an underwritten offering.

With respect to each offering of securities pursuant to this prospectus, among other information, the following will be set forth in, or may be calculated from the information set forth in, the related prospectus supplement or term sheet:

- the terms of any offering, including the name or names of any underwriters, dealers or agents, the purchase price of such series of debt securities and the proceeds to us from such sale;
- any underwriting discounts, selling commissions and other items constituting underwriters , dealers or agents compensation;
- any initial public offering price and any discounts or concessions allowed or reallowed or paid to dealers or agents; and

any securities exchanges on which the securities of the series may be listed.

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LEGAL OPINIONS

The validity of the securities offered by this prospectus will be passed upon by McDermott Will & Emery LLP. Legal counsel to any underwriters may pass upon legal matters for such underwriters.

EXPERTS

The consolidated financial statements of Constellation Brands, Inc. and subsidiaries as of February 29, 2012 and February 28, 2011, and for each of the years in the three-year period ended February 29, 2012, and management s assessment of the effectiveness of internal control over financial reporting as of February 29, 2012, have been incorporated by reference herein in reliance upon the reports of KPMG LLP, independent registered public accounting firm, incorporated by reference herein, and upon the authority of said firm as experts in accounting and auditing.

The financial statements of Crown Imports LLC incorporated in this Prospectus by reference to Constellation Brands, Inc. s Annual Report on Form 10-K, for the year ended February 29, 2012 have been so incorporated in reliance on the report of PricewaterhouseCoopers LLP, independent accountants, given on the authority of said firm as experts in auditing and accounting.

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$650,000,000

4.625% Senior Notes due 2023

PROSPECTUS SUPPLEMENT

August 6, 2012

Joint Book Running Managers

BofA Merrill Lynch

J.P. Morgan

Rabo Securities

Barclays

Wells Fargo Securities

Co-Managers

HSBC

Mitsubishi UFJ Securities

ebt are both carried on the Company's condensed consolidated balance sheets.

Significant Accounting Policies

Mortgage Servicing Rights, at Fair Value

The MSRs acquired in conjunction with the acquisition of the Company's MSR subsidiary represent the right to service mortgage loans. As of June 30, 2013, the Company and its subsidiaries do not originate or directly service mortgage loans, and instead contract with fully licensed subservicers to handle all servicing functions for the loans underlying the Company's MSRs. However, as an owner and manager of MSRs, the Company may be obligated to fund advances of principal and interest payments due to third party owners of the loans, but not yet received from the individual borrowers. These advances are reported as servicing advances within the other assets line item on the condensed consolidated balance sheets.

MSRs are reported at fair value within the other assets line item on the condensed consolidated balance sheets. Changes in the fair value of MSRs as well as servicing fee income are reported within other income on the condensed consolidated statements of comprehensive (loss) income. The related subservicing expenses are recorded in other operating expenses on the condensed consolidated statements of comprehensive (loss) income.

See Note 13 - Other Assets for further discussion on MSRs.

Equity Incentive Plan

The Company adopted an equity incentive plan in 2009 which provides incentive compensation to attract and retain qualified directors, officers, advisors, consultants and other personnel, including PRCM Advisers LLC and its affiliates. The 2009 equity incentive plan is administered by the compensation committee of the Company's board of directors. The 2009 equity incentive plan permits the granting of restricted shares of common stock, phantom shares, dividend equivalent rights and other equity-based awards.

On May 21, 2013, the Company’s stockholders approved the restated 2009 equity incentive plan, which effectuated, among other changes, an increase in the number of shares available for issuance under the restated 2009 equity incentive plan by 2,800,000 shares of common stock. Other amendments provide for the possibility of making grants of equity-based compensation to the Company’s executive officers and other key employees of the Company’s external manager, PRCM Advisers LLC, upon a determination by the compensation committee, and the implementation of certain best practices of equity-based compensation.

The cost of equity-based compensation awarded to employees of our manager is determined using fair value liability accounting in accordance with ASC 718, Compensation - Stock Compensation, or ASC 718, and amortized over the vesting term.

Offsetting Assets and Liabilities

Certain of the Company's repurchase agreements are governed by underlying agreements that provide for a right of setoff in the event of default of either party to the agreement. The Company also has netting arrangements in place with all derivative counterparties pursuant to standard documentation developed by the International Swap and Derivatives Association, or ISDA. Additionally, the Company and the counterparty are required to post cash collateral based upon the net underlying market value of the Company's open positions with the counterparty.

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TWO HARBORS INVESTMENT CORP.
Notes to the Condensed Consolidated Financial Statements (unaudited)

Under GAAP, if the Company has a valid right of setoff, it may offset the related asset and liability and report the net amount. The Company presents repurchase agreements subject to master netting arrangements or similar agreements on a gross basis, and derivative assets and liabilities subject to such arrangements on a net basis, based on derivative type and counterparty, in its condensed consolidated balance sheets. Separately, the Company presents cash collateral subject to such arrangements on a net basis, based on counterparty, in its condensed consolidated balance sheets. However, the Company does not offset financial assets and liabilities with the associated cash collateral on its condensed consolidated balance sheets.
The following tables present information about the Company's assets and liabilities that are subject to master netting arrangements or similar agreements and can potentially be offset on the Company's condensed consolidated balance sheets as of June 30, 2013 and December 31, 2012:

	June 30, 2013					
				Gross Amounts Not Offset with Financial Assets (Liabilities) in the Condensed Consolidated Balance Sheets (1)		
(in thousands)	Gross Amounts of Recognized Assets (Liabilities)	Gross Amounts Offset in the Condensed Consolidated Balance Sheets	Net Amounts of Assets (Liabilities) Presented in the Condensed Consolidated Balance Sheets	Financial Instruments	Cash Collateral (Received) Pledged	Net Amount
Assets						
Derivative assets	$723,246	$(23,895)	$699,351	$(46,028)	$(189,927)	$463,396
Total Assets	$723,246	$(23,895)	$699,351	$(46,028)	$(189,927)	$463,396
Liabilities						
Repurchase agreements	$(14,903,155)	$—	$(14,903,155)	$14,903,155	$—	$—
Derivative liabilities	(69,923)	23,895	(46,028)	46,028	—	—
Total Liabilities	$(14,973,078)	$23,895	$(14,949,183)	$14,949,183	$—	$—

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TWO HARBORS INVESTMENT CORP.
Notes to the Condensed Consolidated Financial Statements (unaudited)

	December 31, 2012					
				Gross Amounts Not Offset with Financial Assets (Liabilities) in the Condensed Consolidated Balance Sheets (1)		
(in thousands)	Gross Amounts of Recognized Assets (Liabilities)	Gross Amounts Offset in the Condensed Consolidated Balance Sheets	Net Amounts of Assets (Liabilities) Presented in the Condensed Consolidated Balance Sheets	Financial Instruments	Cash Collateral (Received) Pledged	Net Amount
Assets						
Derivative assets	$463,027	$(947)	$462,080	$(129,294)	$85,798	$418,584
Total Assets	$463,027	$(947)	$462,080	$(129,294)	$85,798	$418,584
Liabilities						
Repurchase agreements	$(12,624,510)	$—	$(12,624,510)	$12,624,510	$—	$—
Derivative liabilities	(130,241)	947	(129,294)	129,294	—	—
Total Liabilities	$(12,754,751)	$947	$(12,753,804)	$12,753,804	$—	$—

(1) Amounts presented are limited in total to the net amount of assets or liabilities presented in the condensed consolidated balance sheets by instrument. Excess cash collateral or financial assets that are pledged to counterparties may exceed the financial liabilities subject to a master netting arrangement or similar agreement, or counterparties may have pledged excess cash collateral to the Company that exceed the corresponding financial assets. These excess amounts are excluded from the table above, although separately reported within restricted cash, due from counterparties, or due to counterparties in the Company's condensed consolidated balance sheets.

Refer to Note 2 to the Consolidated Financial Statements in the Company's 2012 Annual Report on Form 10-K regarding additional significant accounting policies.

Recently Issued and/or Adopted Accounting Standards

Offsetting Assets and Liabilities

In December 2011, the Financial Accounting Standards Board, or FASB, issued ASU No. 2011-11, which amends ASC 210, Balance Sheet. The amendments in this ASU enhance disclosures required by U.S. GAAP by requiring improved information about financial instruments and derivative instruments that are either (1) offset in accordance with ASC 210, Balance Sheet or ASC 815, Other Presentation Matters or (2) subject to an enforceable master netting arrangement or similar agreement. ASU 2011-11 is effective for the first interim or annual period beginning on or after January 1, 2013. In January 2013, the FASB issued ASU No. 2013-01, which limits the scope of ASU 2011-11 to certain derivatives, repurchase agreements and securities lending arrangements. ASU 2013-01 is also effective for the first interim or annual period beginning on or after January 1, 2013. Adopting both ASU 2011-11 and ASU 2013-01 did not have any impact on the Company's condensed consolidated financial condition or results of operations, but did impact financial statement disclosures.

Comprehensive Income

In February 2013, the FASB issued ASU No. 2013-02, which amends ASC 220, Comprehensive Income. The amendments are intended to make the presentation of items within Other Comprehensive Income (OCI) more prominent. ASU 2013-02 requires reclassification adjustments between OCI and net income to be presented separately on the face of the financial statements. The new guidance does not change the requirement to present items of net income and OCI, and totals for net income, OCI and comprehensive income in a single continuous statement or two consecutive statements. ASU 2013-02 is effective for the first interim or annual period beginning on or after December 15, 2012. Adopting this ASU did not have any impact on the Company's condensed consolidated financial condition or results of operations, but did impact financial statement disclosures.

Note 3. Variable Interest Entities

During the six months ended June 30, 2013, the Company purchased subordinated debt and excess servicing rights from a securitization trust issued by a third party. The securitization trust is considered a VIE for financial reporting purposes and,

TWO HARBORS INVESTMENT CORP.
Notes to the Condensed Consolidated Financial Statements (unaudited)

thus, was reviewed for consolidation under the applicable consolidation guidance. Since the Company has both the power to direct the activities of the securitization trust that most significantly impact the entity's performance, and the obligation to absorb losses or the right to receive benefits of the entity that could be significant, the Company consolidates the trust. As the Company is required to reassess VIE consolidation guidance each quarter, new facts and circumstances may change the Company's determination. This could result in a material impact to the Company's financial statements during subsequent reporting periods.
The following table presents a summary of the assets and liabilities of the securitization trust:

(in thousands)	June 30, 2013	December 31, 2012
Mortgage loans held-for-investment in securitization trust	$401,347	$—
Accrued interest receivable	1,428	—
Total Assets	$402,775	$—
Collateralized borrowings in securitization trust	363,012	—
Accrued interest payable	715	—
Accrued expenses	92	—
Total Liabilities	$363,819	$—

Note 4. Discontinued Operations
On December 19, 2012, the Company completed the contribution of its equity interests in its wholly owned subsidiary, Two Harbors Property Investment LLC, to Silver Bay. Two Harbors Property Investment LLC previously housed the Company's portfolio of single-family rental properties. As the Company will not have any significant continuing involvement in Two Harbors Property Investment LLC, all of the associated operating results were removed from continuing operations and are presented separately as discontinued operations for the three and six months ended June 30, 2013 and 2012.
Summarized financial information for the discontinued operations are presented below.

(in thousands)	Three Months Ended June 30, 2013	Three Months Ended June 30, 2012	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
Income:				
Gain on contribution of entity	$1,016	$—	$2,255	$—
Real estate related revenues	—	83	—	87
Total income	1,016	83	2,255	87
Expenses:				
Management fees	—	—	—	—
Real estate related expenses	—	181	—	198
Other operating expenses	—	83	(138)	116
Total expenses	—	264	(138)	314
Income (loss) from discontinued operations	$1,016	$(181)	$2,393	$(227)

In addition to the gain on contribution of entity that was recorded in 2012 in connection with the closing of the contribution, certain adjustments were agreed to be recognized in 2013. These include an installment sales gain of approximately $4.0 million from Silver Bay, a reduction of 2013 management fees payable to PRCM Advisers of $4.3 million, and an immaterial amount of additional working capital adjustments determined in accordance with the contribution agreement entered into with Silver Bay. Of these amounts, $1.0 million and $2.3 million of the installment sales gain was recorded as a gain on contribution of entity within discontinued operations for the three and six months ended June 30, 2013, and the full $4.3 million of the reduction of 2013 management fees payable to

PRCM Advisers was recorded within management fees, on the condensed consolidated statements of comprehensive (loss) income for the six months ended June 30, 2013, respectively. The remaining $0.1 million recorded within discontinued operations on the condensed consolidated statements of comprehensive (loss)

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Notes to the Condensed Consolidated Financial Statements (unaudited)

income for the six months ended June 30, 2013 relates to accrual adjustments for transaction expenses related to the contribution. See Note 23 - Related Party Transactions for additional information.

Note 5. Available-for-Sale Securities, at Fair Value
The following table presents the Company's available-for-sale, or AFS, investment securities by collateral type, which were carried at their fair value as of June 30, 2013 and December 31, 2012:

(in thousands)	June 30, 2013	December 31, 2012
Mortgage-backed securities:		
Agency		
Federal Home Loan Mortgage Corporation	$4,056,456	$3,608,272
Federal National Mortgage Association	5,867,736	5,130,965
Government National Mortgage Association	2,016,636	2,272,866
Non-Agency	2,951,487	2,654,851
Total mortgage-backed securities	$14,892,315	$13,666,954

At June 30, 2013 and December 31, 2012, the Company pledged investment securities with a carrying value of $14.2 billion and $12.8 billion, respectively, as collateral for repurchase agreements. See Note 16 - Repurchase Agreements. At June 30, 2013 and December 31, 2012, the Company did not have any securities purchased from and financed with the same counterparty that did not meet the conditions of ASC 860, Transfers and Servicing, to be considered linked transactions and, therefore, classified as derivatives.
The following tables present the amortized cost and carrying value (which approximates fair value) of AFS securities by collateral type as of June 30, 2013 and December 31, 2012:

	June 30, 2013		
(in thousands)	Agency	Non-Agency	Total
Face Value	$13,791,266	$4,994,692	$18,785,958
Unamortized premium	809,226	—	809,226
Unamortized discount			
Designated credit reserve	—	(1,386,607)	(1,386,607)
Net, unamortized	(2,359,641)	(1,222,618)	(3,582,259)
Amortized Cost	12,240,851	2,385,467	14,626,318
Gross unrealized gains	101,471	577,151	678,622
Gross unrealized losses	(401,494)	(11,131)	(412,625)
Carrying Value	$11,940,828	$2,951,487	$14,892,315

	December 31, 2012		
(in thousands)	Agency	Non-Agency	Total
Face Value	$11,934,492	$4,503,999	$16,438,491
Unamortized premium	749,252	—	749,252
Unamortized discount			
Designated credit reserve	—	(1,290,946)	(1,290,946)
Net, unamortized	(1,929,811)	(996,490)	(2,926,301)
Amortized Cost	10,753,933	2,216,563	12,970,496
Gross unrealized gains	276,293	448,403	724,696
Gross unrealized losses	(18,123)	(10,115)	(28,238)
Carrying Value	$11,012,103	$2,654,851	$13,666,954

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TWO HARBORS INVESTMENT CORP.
Notes to the Condensed Consolidated Financial Statements (unaudited)

The following tables present the carrying value of the Company's AFS investment securities by rate type as of June 30, 2013 and December 31, 2012:

	June 30, 2013		
(in thousands)	Agency	Non-Agency	Total
Adjustable Rate	$170,682	$2,543,467	$2,714,149
Fixed Rate	11,770,146	408,020	12,178,166
Total	$11,940,828	$2,951,487	$14,892,315

	December 31, 2012		
(in thousands)	Agency	Non-Agency	Total
Adjustable Rate	$188,429	$2,334,950	$2,523,379
Fixed Rate	10,823,674	319,901	11,143,575
Total	$11,012,103	$2,654,851	$13,666,954

When the Company purchases a credit-sensitive AFS security at a significant discount to its face value, the Company often does not amortize into income a significant portion of this discount that the Company is entitled to earn because it does not expect to collect it due to the inherent credit risk of the security. The Company may also record an other-than-temporary impairment, or OTTI, for a portion of its investment in the security to the extent the Company believes that the amortized cost will exceed the present value of expected future cash flows. The amount of principal that the Company does not amortize into income is designated as a credit reserve on the security, with unamortized net discounts or premiums amortized into income over time to the extent realizable.

The following table presents the changes for the six months ended June 30, 2013 and 2012, of the unamortized net discount and designated credit reserves on non-Agency AFS securities.

	Six Months Ended June 30,					
	2013			2012		
(in thousands)	Designated Credit Reserve	Unamortized Net Discount	Total	Designated Credit Reserve	Unamortized Net Discount	Total
Beginning balance at January 1	$(1,290,946)	$(996,490)	$(2,287,436)	$(782,606)	$(540,969)	$(1,323,575)
Acquisitions	(158,955)	(365,348)	(524,303)	(553,552)	(479,435)	(1,032,987)
Accretion of net discount	886	71,625	72,511	250	62,768	63,018
Realized credit losses	22,658	—	22,658	17,908	—	17,908
Reclassification adjustment for other-than-temporary impairments	(1,662)	—	(1,662)	(8,751)	—	(8,751)
Transfers from (to)	30,883	(30,883)	—	—	—	—
Sales, calls, other	10,529	98,478	109,007	4,653	13,338	17,991
Ending balance at June 30	$(1,386,607)	$(1,222,618)	$(2,609,225)	$(1,322,098)	$(944,298)	$(2,266,396)

TWO HARBORS INVESTMENT CORP.
Notes to the Condensed Consolidated Financial Statements (unaudited)

The following table presents the components comprising the carrying value of AFS securities not deemed to be other than temporarily impaired by length of time the securities had an unrealized loss position as of June 30, 2013 and December 31, 2012. At June 30, 2013, the Company held 1,732 AFS securities, of which 863 were in an unrealized loss position for less than twelve consecutive months and 35 were in an unrealized loss position for more than twelve consecutive months. Of the $8.5 billion and $2.5 billion of AFS securities in an unrealized loss position for less than twelve consecutive months as of June 30, 2013 and December 31, 2012, $8.2 billion, or 97.5%, and $2.4 billion, or 95.8%, respectively, were Agency AFS securities, whose principal and interest are guaranteed by government sponsored entities, or GSEs. At December 31, 2012, the Company held 1,493 AFS securities, of which 250 were in an unrealized loss position for less than twelve months and 47 were in an unrealized loss position for more than twelve consecutive months.

	Unrealized Loss Position for Less than 12 Months		12 Months or More		Total	
(in thousands)	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
June 30, 2013	$8,461,815	$(405,056)	$62,024	$(7,569)	$8,523,839	$(412,625)
December 31, 2012	$2,548,995	$(18,610)	$52,689	$(9,628)	$2,601,684	$(28,238)

Evaluating AFS Securities for Other-Than-Temporary Impairments

In order to evaluate AFS securities for OTTI, the Company determines whether there has been a significant adverse quarterly change in the cash flow expectations for a security. The Company compares the amortized cost of each security in an unrealized loss position against the present value of expected future cash flows of the security. The Company also considers whether there has been a significant adverse change in the regulatory and/or economic environment as part of this analysis. If the amortized cost of the security is greater than the present value of expected future cash flows using the original yield as the discount rate, an other-than-temporary credit impairment has occurred. If the Company does not intend to sell and is not more likely than not required to sell the security, the credit loss is recognized in earnings and the balance of the unrealized loss is recognized in other comprehensive (loss) income. If the Company intends to sell the security or will be more likely than not required to sell the security, the full unrealized loss is recognized in earnings.

The Company recorded a $1.4 million and a $1.7 million other-than-temporary credit impairment during the three and six months ended June 30, 2013, respectively, on a total of four non-Agency RMBS where the future expected cash flows for each security was less than its amortized cost. As of June 30, 2013, impaired securities had weighted average cumulative losses of 10.9%, weighted average three-month prepayment speed of 6.7%, weighted average 60+ day delinquency of 35.6% of the pool balance, and weighted average FICO score of 626. At June 30, 2013, the Company did not intend to sell the securities and determined that it was not more likely than not that the Company will be required to sell the securities, therefore, only the projected credit loss was recognized in earnings. During the three and six months ended June 30, 2012, the Company recorded a $4.5 million and an $8.8 million other-than-temporary credit impairment on a total of 27 non-Agency RMBS where the future expected cash flows for each security was less than its amortized cost.

TWO HARBORS INVESTMENT CORP.
Notes to the Condensed Consolidated Financial Statements (unaudited)

The following table presents the changes in OTTI included in earnings for three and six months ended June 30, 2013 and 2012:

	Three Months Ended June 30,		Six Months Ended June 30,	
(in thousands)	2013	2012	2013	2012
Cumulative credit loss at beginning of period	$(15,142)	$(9,377)	$(15,561)	$(5,102)
Additions:				
Other-than-temporary impairments not previously recognized	—	(2,644)	—	(6,128)
Increases related to other-than-temporary impairments on securities with previously recognized other-than-temporary impairments	(1,426)	(1,832)	(1,662)	(2,623)
Reductions:				
Decreases related to other-than-temporary impairments on securities paid down	231	250	231	250
Decreases related to other-than-temporary impairments on securities sold	1,291	—	1,946	—
Cumulative credit loss at end of period	$(15,046)	$(13,603)	$(15,046)	$(13,603)

Cumulative credit losses related to OTTI may be reduced for securities sold as well as for securities that mature, pay down, or are prepaid such that the outstanding principal balance is reduced to zero. Additionally, increases in cash flows expected to be collected over the remaining life of the security cause a reduction in the cumulative credit loss.
Gross Realized Gains and Losses
Gains and losses from the sale of AFS securities are recorded as realized gains (losses) within gain on investment securities in the Company's condensed consolidated statements of comprehensive (loss) income. For the three and six months ended June 30, 2013, the Company sold AFS securities for $189.7 million and $986.4 million with an amortized cost of $137.3 million and $915.0 million, for net realized gains of $52.4 million and $71.4 million, respectively.
The following table presents the gross realized gains and losses on sales of AFS securities for the three and six months ended June 30, 2013 and 2012:

	Three Months Ended June 30,		Six Months Ended June 30,	
(in thousands)	2013	2012	2013	2012
Gross realized gains	$52,439	$560	$75,665	$11,663
Gross realized losses	(1)	(1,629)	(4,297)	(1,629)
Total realized gains on sales, net	$52,438	$(1,069)	$71,368	$10,034

Note 6. Trading Securities, at Fair Value
The Company holds U.S. Treasuries in a taxable REIT subsidiary and classifies these securities as trading instruments due to short-term investment objectives. As of June 30, 2013 and December 31, 2012, the Company held U.S. Treasuries with an amortized cost of $1.0 billion and a fair value of $1.0 billion for both periods classified as trading securities. The unrealized gains included within trading securities were $3.5 million and $5.0 million as of June 30, 2013 and December 31, 2012, respectively.
The Company did not sell any trading securities during the three and six months ended June 30, 2013. For both the three and six months ended June 30, 2013, trading securities experienced change in unrealized losses of $1.6 million. Unrealized gains and losses are recorded as a component of gains on investment securities in the Company's

condensed consolidated statements of comprehensive (loss) income.

At June 30, 2013, the Company pledged trading securities with a carrying value of $1.0 billion as collateral for repurchase agreements. See Note 16 - Repurchase Agreements.

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Note 7. Equity Securities, at Fair Value

At December 31, 2012, equity securities consisted of shares of Silver Bay common stock carried at fair value as a result of a fair value option election. In exchange for the contribution of the Company's equity interests in its wholly owned subsidiary, Two Harbors Property Investment LLC, to Silver Bay on December 19, 2012, the Company received 17,824,647 shares of common stock, or 47.7%, of Silver Bay at the initial public offering price of $18.50. The initial carrying value of the Company's equity securities was $329.8 million and the carrying value as of December 31, 2012 was $335.6 million, which included $5.9 million in unrealized gains.

On March 18, 2013, the Company declared a special dividend pursuant to which the 17,824,647 shares of Silver Bay common stock would be distributed, on a pro rata basis, to Two Harbors stockholders of record at the close of business on April 2, 2013. The dividend was payable on or about April 24, 2013. As a result, the Company recognized $13.7 million of realized gains on distribution as well as $13.7 million and $5.9 million of change in unrealized losses within gain on investment securities on the condensed consolidated statements of comprehensive (loss) income for the three and six months ended June 30, 2013, respectively. As the shares were distributed to Two Harbors stockholders during the six months ended June 30, 2013, equity securities are no longer recognized on the condensed consolidated balance sheet as of June 30, 2013.

Note 8. Mortgage Loans Held-for-Sale, at Fair Value

Mortgage loans held-for-sale consists of residential mortgage loans carried at fair value as a result of a fair value option election. The following table presents the carrying value of the Company's mortgage loans held-for-sale as of June 30, 2013 and December 31, 2012:

(in thousands)	June 30, 2013	December 31, 2012
Unpaid principal balance	$1,101,389	$56,976
Fair value adjustment	(143,188)	1,631
Carrying value	$958,201	$58,607

At June 30, 2013 and December 31, 2012, the Company pledged mortgage loans with a carrying value of $475.0 million and $52.5 million, respectively, as collateral for repurchase agreements. See Note 16 - Repurchase Agreements.

Note 9. Mortgage Loans Held-for-Investment in Securitization Trust, at Fair Value

During the six months ended June 30, 2013, the Company purchased subordinated debt and excess servicing rights from a securitization trust issued by a third party. The underlying residential mortgage loans held by the trust, which are consolidated on the Company's condensed consolidated balance sheet, are classified as mortgage loans held-for-investment in securitization trust and carried at fair value as a result of a fair value option election. See Note 3 - Variable Interest Entities for additional information regarding consolidation of the securitization trust. The following table presents the carrying value of the Company's mortgage loans held-for-investment in securitization trust as of June 30, 2013 and December 31, 2012:

(in thousands)	June 30, 2013	December 31, 2012
Unpaid principal balance	$405,519	$—
Fair value adjustment	(4,172)	—
Carrying value	$401,347	$—

Note 10. Restricted Cash

The Company is required to maintain certain cash balances with counterparties for broker activity and collateral for the Company's repurchase agreements in non-interest bearing accounts. The Company has also placed cash in a restricted account pursuant to a letter of credit on an office space lease.

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The following table presents the Company's restricted cash balances as of June 30, 2013 and December 31, 2012:

(in thousands)	June 30, 2013	December 31, 2012
Restricted cash balances held by trading counterparties:		
For securities trading activity	$9,000	$9,000
For derivatives trading activity	80,140	208,669
As restricted collateral for repurchase agreements	596,479	84,307
	685,619	301,976
Restricted cash balance pursuant to letter of credit on office lease	346	346
Total	$685,965	$302,322

Note 11. Accrued Interest Receivable
The following table presents the Company's accrued interest receivable by collateral type:

(in thousands)	June 30, 2013	December 31, 2012
Accrued Interest Receivable:		
U.S. Treasuries	$1,101	$1,119
Mortgage-backed securities:		
Agency		
Federal Home Loan Mortgage Corporation	13,660	11,888
Federal National Mortgage Association	19,732	17,101
Government National Mortgage Association	8,880	8,962
Non-Agency	3,926	3,296
Total mortgage-backed securities	46,198	41,247
Mortgage loans held-for-sale	5,353	247
Mortgage loans held-for-investment in securitization trust	1,428	—
Total	$54,080	$42,613

Note 12. Derivative Instruments and Hedging Activities
The Company enters into a variety of derivative and non-derivative instruments in connection with its risk management activities. The Company's primary objective for executing these derivative and non-derivative instruments is to mitigate the Company's economic exposure to future events that are outside its control. The Company's derivative financial instruments are utilized principally to manage market risk and cash flow volatility associated with interest rate risk (including associated prepayment risk) related to certain assets and liabilities. As part of its risk management activities, the Company may, at times, enter into various forward contracts, including short securities, Agency to-be-announced securities, or TBAs, options, futures, swaps, caps and credit default swaps. In executing on the Company's current risk management strategy, the Company has entered into interest rate swap and swaption agreements and credit default swaps. At times, the Company may use TBAs for risk management or other purposes. The Company has also entered into a number of non-derivative instruments to manage interest rate risk, principally U.S. Treasuries and Agency interest-only securities.
The following summarizes the Company's significant asset and liability classes, the risk exposure for these classes, and the Company's risk management activities used to mitigate certain of these risks. The discussion includes both derivative and non-derivative instruments used as part of these risk management activities. While the Company uses non-derivative and derivative instruments to achieve the Company's risk management activities, it is possible that these instruments will not effectively mitigate all or a substantial portion of the Company's market rate risk. In addition, the Company might elect, at times, not to enter into certain hedging arrangements in order to maintain

compliance with REIT requirements.

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Balance Sheet Presentation

The following tables present the gross fair value and notional amounts of the Company's derivative financial instruments treated as trading instruments as of June 30, 2013 and December 31, 2012.

(in thousands)	June 30, 2013			
	Derivative Assets		Derivative Liabilities	
Trading instruments	Fair Value	Notional	Fair Value	Notional
Inverse interest-only securities	$245,195	$1,798,972	$—	$—
Interest rate swap agreements	142,317	18,485,000	—	—
Credit default swap agreements	—	—	(8,198)	1,630,404
Swaptions	225,810	6,250,000	—	—
TBAs	61,156	2,813,000	(22,568)	2,892,000
Put and call options for TBAs	24,873	210,000	—	—
Constant maturity swaps	—	—	(14,058)	19,000,000
Forward purchase commitment	—	—	(1,204)	29,229
Total	$699,351	$29,556,972	$(46,028)	$23,551,633

(in thousands)	December 31, 2012			
	Derivative Assets		Derivative Liabilities	
Trading instruments	Fair Value	Notional	Fair Value	Notional
Inverse interest-only securities	$304,975	$1,909,351	$—	$—
Interest rate swap agreements	—	—	(129,055)	14,070,000
Credit default swap agreements	52,906	438,440	—	—
Swaptions	102,048	4,950,000	—	—
TBAs	1,917	2,414,000	(239)	139,000
Forward purchase commitment	234	56,865	—	—
Total	$462,080	$9,768,656	$(129,294)	$14,209,000

The following table provides the average outstanding notional amounts of the Company's derivative financial instruments treated as trading instruments for the three and six months ended June 30, 2013.

(in thousands)	Three Months Ended June 30, 2013		Six Months Ended June 30, 2013	
Trading instruments	Derivative Assets	Derivative Liabilities	Derivative Assets	Derivative Liabilities
Inverse interest-only securities	$1,895,789	$—	$1,908,919	$—
Interest rate swap agreements	17,655,220	—	16,267,624	—
Credit default swaps	—	764,914	—	602,283
Swaptions	5,748,352	—	5,646,133	—
TBAs	1,959,495	1,234,769	1,588,630	783,227
Put and call options for TBAs	130,901	—	65,812	—
Constant maturity swaps	—	5,532,967	—	2,781,768
Short treasuries	—	26,703	—	13,425
Forward purchase commitment	—	297,207	—	174,920

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Comprehensive Income Statement Presentation
The Company has not applied hedge accounting to its current derivative portfolio held to mitigate the interest rate risk associated with its debt portfolio. As a result, the Company is subject to volatility in its earnings due to movement in the unrealized gains and losses associated with its interest rate swaps and its other derivative instruments.
The following table summarizes the location and amount of gains and losses on derivative instruments reported in the condensed consolidated statements of comprehensive (loss) income on its derivative instruments:
(in thousands)

Trading Instruments	Location of Gain/(Loss) Recognized in Income on Derivatives	Amount of Gain/(Loss) Recognized in Income on Derivatives			
		Three Months Ended June 30,		Six Months Ended June 30,	
		2013	2012	2013	2012
Risk Management Instruments					
Interest Rate Contracts					
Investment securities - RMBS	Gain (loss) on other derivative instruments	$116,709	$(22,350)	$104,057	$(24,987)
Investment securities - U.S. Treasuries and TBA contracts	Gain (loss) on interest rate swap and swaption agreements	409	(5,697)	320	(7,345)
Mortgage loans held-for-sale	(Loss) gain on mortgage loans held-for-sale	(20,302)	(39)	(20,015)	(26)
Repurchase agreements	Gain (loss) on interest rate swap and swaption agreements	259,417	(55,317)	278,478	(69,862)
Credit default swaps - Receive protection	Gain (loss) on other derivative instruments	(4,220)	(1,225)	(9,862)	(25,526)
Non-Risk Management Instruments					
Credit default swaps - Provide protection	Gain (loss) on other derivative instruments	—	752	—	8,972
Inverse interest-only securities	Gain (loss) on other derivative instruments	(40,149)	15,245	(38,920)	25,060
Other TBA positions	Gain (loss) on other derivative instruments	(10,057)	—	(9,654)	—
Total		$301,807	$(68,631)	$304,404	$(93,714)

For the three and six months ended June 30, 2013, the Company recognized $19.4 million and $33.4 million, respectively, of expenses for the accrual and/or settlement of the net interest expense associated with its interest rate swaps. The expenses result from generally paying a fixed interest rate on an average $17.7 billion and $16.3 billion notional, respectively, to economically hedge a portion of the Company's interest rate risk on its short-term repurchase agreements, funding costs, and macro-financing risk and generally receiving LIBOR interest.
For the three and six months ended June 30, 2013, the Company terminated, had agreements mature or had options expire on a total of three and 72 interest rate swap and swaption positions of $300.0 million and $8.5 billion notional, respectively. Upon settlement of the early terminations, contractual maturities and option expirations, the Company paid $17.2 million in full settlement of its net interest spread liability and recognized $4.0 million and $62.7 million in realized losses on the swaps and swaptions, respectively, including early termination penalties.
For the three and six months ended June 30, 2013, the Company terminated a total of five credit default swap positions of $115.0 million notional. Upon settlement of the early terminations, the Company paid $2,035 in full

settlement of its net interest spread liability and recognized $12.4 million in realized losses on the credit default swaps, including early terminations penalties.

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TWO HARBORS INVESTMENT CORP.
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Cash flow activity related to derivative instruments is reflected within the operating activities and investing activities sections of the condensed consolidated statements of cash flows. Derivative fair value adjustments are reflected within the unrealized (gain) loss on interest rate swaps and swaptions, unrealized loss on other derivative instruments, and (gain) loss on mortgage loans held-for-sale line items within the operating activities section of the condensed consolidated statements of cash flows. Realized losses on interest rate swap and swaption agreements are reflected within the loss on termination of interest rate swaps and swaptions line item within the operating activities section of the condensed consolidated statements of cash flows. The remaining cash flow activity related to derivative instruments is reflected within the purchases of other derivative instruments, proceeds from sales of other derivative instruments, and increase in due to counterparties, net line items within the investing activities section of the condensed consolidated statements of cash flows.

Interest Rate Sensitive Assets/Liabilities

Available-for-sale Securities - The Company's RMBS investment securities are generally subject to change in value when mortgage rates decline or increase, depending on the type of investment. Rising mortgage rates generally result in a slowing of refinancing activity, which slows prepayments and results in a decline in the value of the Company's fixed-rate Agency pools. To mitigate the impact of this risk, the Company maintains a portfolio of financial instruments, primarily fixed-rate interest-only securities, which increase in value when interest rates increase. In addition, the Company has initiated TBA positions, put and call options for TBAs, and constant maturity swaps to further mitigate its exposure to higher interest rates, decreased prepayment speeds and widening mortgage spreads. The objective is to reduce the risk of losses to the portfolio caused by interest rate changes and changes in prepayment speeds.

As of June 30, 2013 and December 31, 2012, the Company had outstanding fair value of $95.0 million and $77.3 million, respectively, of interest-only securities in place to economically hedge its investment securities. These interest-only securities are included in AFS securities, at fair value, in the condensed consolidated balance sheets.

In addition, the Company held TBA positions with $1.5 billion and $1.8 billion in long notional as of June 30, 2013 and December 31, 2012, respectively, and an additional $4.2 billion and $800.0 million in short notional as of June 30, 2013 and December 31, 2012, respectively. At June 30, 2013, $92.0 million of the Company's long notional TBA positions and $4.2 billion of the Company's short notional TBA positions were held as a means to mitigate exposure to higher interest rates and wider mortgage spreads, while the remaining $1.4 billion long notional TBA positions were held for non-risk management purposes (see "Non-Risk Management Activities" section). The Company discloses these on a gross basis according to the unrealized gain or loss position of each TBA contract regardless of long or short notional position. These contracts had a fair market value of $61.2 million and $1.9 million, included in derivative assets, at fair value, and $22.6 million and $0.2 million, included in derivative liabilities, at fair value, in the condensed consolidated balance sheet as of June 30, 2013 and December 31, 2012, respectively.

As of June 30, 2013, the Company had purchased put and call options for TBAs with a total notional amount of $1.3 billion and sold put and call options for TBAs with a total notional amount of $1.5 billion. The Company paid upfront premiums of approximately $10.0 million for the options purchased and received upfront premiums of approximately $8.3 million for the options sold. Each of the options will expire by September 2013. The put and call options had a net fair market value of $24.9 million, included in derivative assets, at fair value, in the condensed consolidated balance sheet as of June 30, 2013. The Company did not hold any put or call options for TBAs as of December 31, 2012.

The Company has also entered into constant maturity swaps between the 10-year interest rate swap curve and the yield to maturity on a 30-year Fannie Mae TBA to economically hedge mortgage spread widening. The Company had the following constant maturity swaps agreements in place at June 30, 2013:

(notional and dollars in thousands)

June 30, 2013

	Notional Amount	Fair Value

Determination Date	Average Strike Swap Rate					Upfront Premium Paid	Unrealized Gain/(Loss)	
August 2013	0.837	%	$8,000,000	$(3,497	)	$—	$(3,497	)
September 2013	0.981	%	5,000,000	(6,527	)	—	(6,527	)
November 2013	0.900	%	1,000,000	(670	)	—	(670	)
December 2013	0.890	%	5,000,000	(3,364	)	—	(3,364	)
Total	0.892	%	$19,000,000	$(14,058	)	$—	$(14,058	)

The Company did not hold any constant maturity swaps as of December 31, 2012.

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Commitments to Purchase and/or Sell Mortgage Loans Held-for-Sale - Prior to a mortgage loan purchase, the Company may enter into forward purchase commitments with counterparties whereby the Company commits to purchasing the loans at a particular interest rate, provided the borrower elects to close the loan. These commitments to purchase mortgage loans have been defined as derivatives and are, therefore, recorded on the balance sheet as assets or liabilities and measured at fair value. Subsequent changes in fair value are recorded on the balance sheet as adjustments to the carrying value of these assets or liabilities with a corresponding adjustment recognized in current period earnings. As of June 30, 2013 and December 31, 2012, the Company had entered into commitments to purchase $29.2 million and $56.9 million of mortgage loans, respectively, subject to fallout if the loans do not close, with a fair value of $1.2 million included in derivative liabilities on the condensed consolidated balance sheet at June 30, 2013 and $0.2 million included in derivative assets on the condensed consolidated balance sheet at December 31, 2012.

The Company is exposed to interest rate risk on mortgage loans from the time it commits to purchase the mortgage loan until it acquires the loan from the originator and subsequently sells the loan to a third party. Changes in interest rates impact the market price for the mortgage loans. For example, as market interest rates decline, the value of mortgage loans held-for-sale increases, and vice versa. To mitigate the impact of this risk, the Company may from time to time enter into a forward sale commitment under the Forward AAA Securities Agreement, or the Forward Agreement, with Barclays Bank PLC, or Barclays, pursuant to which Barclays would purchase certain securities issued in connection with a potential securitization transaction involving mortgage loans subject to the Forward Agreement. As of June 30, 2013, the Company had did not have any trades under the Forward Agreement. The Company may also enter into other derivative contracts to hedge the interest rate risk related to the commitments to purchase mortgage loans, such as interest rate swaps, swaptions or TBAs.

Repurchase Agreements - The Company monitors its repurchase agreements, which are generally floating rate debt, in relation to the rate profile of its investment securities. When it is cost effective to do so, the Company may enter into interest rate swap arrangements to align the interest rate composition of its investment securities and debt portfolios, specifically repurchase agreements with maturities of less than 6 months. Typically, the interest receivable terms (i.e., LIBOR) of the interest rate swaps match the terms of the underlying debt, resulting in an effective conversion of the rate of the related repurchase agreement from floating to fixed.

As of June 30, 2013 and December 31, 2012, the Company had the following outstanding interest rate swaps that were utilized as economic hedges of interest rate exposure (or duration) associated with the Company's short-term repurchase agreements:

(notional in thousands)
June 30, 2013

Swaps Maturities	Notional Amount	Average Fixed Pay Rate		Average Receive Rate		Average Maturity (Years)
2013	$500,000	0.523	%	0.274	%	0.15
2014	900,000	0.316	%	0.277	%	0.54
2015	4,000,000	0.386	%	0.278	%	1.53
2016	2,650,000	0.579	%	0.276	%	2.67
2017 and Thereafter	9,435,000	0.999	%	0.277	%	4.58
Total	$17,485,000	0.746	%	0.277	%	3.26

(notional in thousands)
December 31, 2012

Swaps Maturities	Notional Amount	Average Fixed Pay Rate		Average Receive Rate		Average Maturity (Years)
2013	$2,275,000	0.713	%	0.315	%	0.56
2014	1,675,000	0.644	%	0.311	%	1.57

2015	2,770,000	0.908	% 0.313	% 2.43	
2016	1,940,000	0.874	% 0.323	% 3.46	
2017 and Thereafter	3,910,000	0.960	% 0.313	% 4.72	
Total	$12,570,000	0.850	% 0.315	% 2.85	

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The Company has also entered into interest rate swaps in combination with U.S. Treasuries to economically hedge funding cost risk. As of June 30, 2013 and December 31, 2012, the Company held $1.0 billion in fair value of U.S. Treasuries classified as trading securities and the following outstanding interest rate swaps:

(notional in thousands)
June 30, 2013

Swaps Maturities	Notional Amount	Average Fixed Pay Rate		Average Receive Rate		Average Maturity (Years)
2015	$1,000,000	0.799	%	0.280	%	1.78
Total	$1,000,000					

(notional in thousands)
December 31, 2012

Swaps Maturities	Notional Amount	Average Fixed Pay Rate		Average Receive Rate		Average Maturity (Years)
2015	$1,000,000	0.799	%	0.350	%	2.28
Total	$1,000,000					

As of December 31, 2012, the Company had the following outstanding interest rate swaps that were entered into in combination with TBA contracts to economically hedge mortgage interest rate exposure (or duration):

(notional in thousands)
December 31, 2012

Swaps Maturities	Notional Amount	Average Fixed Pay Rate		Average Receive Rate		Average Maturity (Years)
2014	$500,000	0.399	%	0.356	%	1.78
Total	$500,000					

The Company did not hold any interest rate swaps entered into in combination with TBA contracts to economically hedge mortgage interest rate exposure (or duration) at June 30, 2013.

As of June 30, 2013 and December 31, 2012, the Company had the following outstanding interest rate swaptions (agreements to enter into interest rate swaps in the future for which the Company would pay a fixed rate) that were utilized as macro-economic hedges:

June 30, 2013

(notional and dollars in thousands)	Option				Underlying Swap				
Swaption	Expiration	Cost	Fair Value	Average Months to Expiration	Notional Amount	Average Fixed Pay Rate		Average Receive Rate	Average Term (Years)
Payer	< 6 Months	$28,213	$4,639	2.15	$2,750,000	3.13	%	3M Libor	8.2
Payer	≥ 6 Months	133,710	221,171	49.35	3,500,000	3.94	%	3M Libor	10.0
Total Payer		$161,923	$225,810	46.65	$6,250,000	3.58	%	3M Libor	9.2

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December 31, 2012 (notional and dollars in thousands)	Option				Underlying Swap			
Swaption	Expiration	Cost	Fair Value	Average Months to Expiration	Notional Amount	Average Fixed Pay Rate	Average Receive Rate	Average Term (Years)
Payer	< 6 Months	$3,983	$30	5.38	$300,000	4.00 %	3M Libor	10.0
Payer	≥ 6 Months	129,925	102,018	53.38	4,650,000	3.74 %	3M Libor	9.7
Total Payer		$133,908	$102,048	53.38	$4,950,000	3.75 %	3M Libor	9.8

The Company has not applied hedge accounting to its current derivative portfolio held to mitigate the interest rate risk associated with its debt portfolio. As a result, the Company is subject to volatility in its earnings due to movement in the unrealized gains and losses associated with its interest rate swaps and its other derivative instruments.

Foreign Currency Risk

In compliance with the Company's REIT requirements, the Company does not have exposure to foreign denominated assets or liabilities. As such, the Company is not subject to foreign currency risk.

Credit Risk

The Company's exposure to credit losses on its U.S. Treasuries and Agency portfolio of investment securities is limited because these securities are issued by the U.S. Department of the Treasury or GSEs. The payment of principal and interest on the Freddie Mac and Fannie Mae mortgage-backed securities are guaranteed by those respective agencies, and the payment of principal and interest on the Ginnie Mae mortgage-backed securities are backed by the full faith and credit of the U.S. Government.

For non-Agency investment securities and mortgage loans, the Company may enter into credit default swaps to hedge credit risk. In future periods, the Company could enhance its credit risk protection, enter into further paired derivative positions, including both long and short credit default swaps, and/or seek opportunistic trades in the event of a market disruption (see "Non-Risk Management Activities" section). The Company also has processes and controls in place to monitor, analyze, manage and mitigate its credit risk with respect to non-Agency RMBS and mortgage loans.

As of June 30, 2013, the Company held credit default swaps whereby the Company receives credit protection for a fixed premium. The maximum payouts for these credit default swaps are limited to the current notional amounts of each swap contract. Maximum payouts for credit default swaps do not represent the expected future cash requirements, as the Company's credit default swaps are typically liquidated or expire and are not exercised by the holder of the credit default swaps.

The following tables present credit default swaps whereby the Company is receiving protection held as of June 30, 2013 and December 31, 2012:

(notional and dollars in thousands)
June 30, 2013

Protection	Maturity Date	Average Implied Credit Spread	Current Notional Amount	Fair Value	Upfront (Payable)/Receivable	Unrealized Gain/(Loss)
Receive	9/20/2013	460.00	$(45,000)	$(91)	$ (3,127)	$(3,218)
	12/20/2013	181.91	(105,000)	(116)	(3,225)	(3,341)
	6/20/2016	105.50	(100,000)	(1,722)	(260)	(1,982)
	12/20/2016	496.00	(25,000)	245	(4,062)	(3,817)
	6/20/2018	247.35	(1,300,000)	(22,858)	21,277	(1,581)
	5/25/2046	356.00	(55,404)	16,344	(25,758)	(9,414)

Total	247.81	$(1,630,404)	$(8,198)	$ (15,155)	$(23,353)

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(notional and dollars in thousands)
December 31, 2012

Protection	Maturity Date	Average Implied Credit Spread	Current Notional Amount	Fair Value	Upfront Payable	Unrealized Gain/(Loss)
Receive	9/20/2013	460.00	$(45,000)	$(264)	$(3,127)	$(3,391)
	12/20/2013	181.91	(105,000)	(198)	(3,225)	(3,423)
	6/20/2016	105.50	(100,000)	(1,940)	(260)	(2,200)
	12/20/2016	496.00	(25,000)	527	(4,062)	(3,535)
	5/25/2046	297.60	(163,440)	54,781	(71,114)	(16,333)
	Total	254.06	$(438,440)	$52,906	$(81,788)	$(28,882)

Derivative financial instruments contain an element of credit risk if counterparties are unable to meet the terms of the agreements. Credit risk associated with derivative financial instruments is measured as the net replacement cost should the counterparties that owe the Company under such contracts completely fail to perform under the terms of these contracts, assuming there are no recoveries of underlying collateral, as measured by the market value of the derivative financial instruments. As of June 30, 2013, the fair value of derivative financial instruments as an asset and liability position was $699.4 million and $46.0 million, respectively.

The Company mitigates the credit risk exposure on derivative financial instruments by limiting the counterparties to those major banks and financial institutions that meet established credit guidelines; the Company also seeks to transact with several different counterparties in order to reduce the exposure to any single counterparty. Additionally, the Company reduces credit risk on the majority of its derivative instruments by entering into agreements that permit the closeout and netting of transactions with the same counterparty upon occurrence of certain events. To further mitigate the risk of counterparty default, the Company maintains collateral agreements with certain of its counterparties. The agreements require both parties to maintain cash deposits in the event the fair values of the derivative financial instruments exceed established thresholds. As of June 30, 2013, the Company has received cash deposits from counterparties of $271.9 million and placed cash deposits of $82.6 million in accounts maintained by counterparties, of which the amounts are netted on a counterparty basis and classified within restricted cash, due from counterparties, or due to counterparties on the condensed consolidated balance sheet.

In accordance with ASC 815, as amended and interpreted, the Company records derivative financial instruments on its condensed consolidated balance sheet as assets or liabilities at fair value. Changes in fair value are accounted for depending on the use of the derivative instruments and whether they qualify for hedge accounting treatment. Due to the volatility of the credit markets and difficulty in effectively matching pricing or cash flows, the Company has elected to treat all current derivative contracts as trading instruments.

Non-Risk Management Activities

The Company has entered into certain financial instruments that are considered derivative contracts under ASC 815 that are not for purposes of hedging. These contracts are currently limited to inverse interest-only RMBS, credit default swaps and TBAs. As of June 30, 2013, we held $1.4 billion notional TBAs as a means of deploying capital until targeted investments are available, and to take advantage of temporary displacements in the marketplace.

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Inverse interest-only securities with a carrying value of $245.2 million, including accrued interest receivable of $3.3 million, are accounted for as derivative financial instruments in the condensed consolidated financial statements. The following table presents the amortized cost and carrying value (which approximates fair value) of inverse interest-only securities as of June 30, 2013 and December 31, 2012:

(in thousands)	June 30, 2013	December 31, 2012
Face Value	$1,798,972	$1,909,351
Unamortized premium	—	—
Unamortized discount		
Designated credit reserve	—	—
Net, unamortized	(1,524,333)	(1,620,966)
Amortized Cost	274,639	288,385
Gross unrealized gains	4,165	21,616
Gross unrealized losses	(36,956)	(8,737)
Carrying Value	$241,848	$301,264

Note 13. Other Assets
Other assets as of June 30, 2013 and December 31, 2012 are summarized in the following table:

(in thousands)	June 30, 2013	December 31, 2012
Property and equipment at cost	$1,937	$1,034
Accumulated depreciation (1)	(507)	(251)
Net property and equipment	1,430	783
Mortgage servicing rights, at fair value	1,452	—
Prepaid expenses	1,065	1,411
Current income tax receivable	—	4,323
Deferred tax assets	—	44,184
Intangible assets	1,600	—
Servicing advances	4,881	—
Other receivables (2)	3,458	31,885
Total other assets	$13,886	$82,586

(1) Depreciation expense for the three and six months ended June 30, 2013 was $141,978 and $255,605, respectively.
(2) The majority of other receivables at December 31, 2012 are amounts due from the Company's transfer agent for cash proceeds received upon exercise of warrants by warrantholders on December 31, 2012.

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Mortgage Servicing Rights
On April 30, 2013, one of the Company's wholly-owned subsidiaries acquired a company that has seller-servicer approvals from Fannie Mae, Freddie Mac and Ginnie Mae to hold and manage MSRs. The MSRs acquired in conjunction with this acquisition represent the right to service mortgage loans. The Company and its subsidiaries do not originate or directly service mortgage loans, and instead contract with fully licensed subservicers to handle all servicing functions for the loans underlying the Company's MSRs. The following table summarizes activity related to MSRs, for the three and six months ended June 30, 2013.

(in thousands)	Three Months Ended June 30, 2013	Six Months Ended June 30, 2013
Balance at beginning of period	$—	$—
Additions	1,497	1,497
Changes in fair value due to:		
Changes in fair value assumptions	—	—
Other changes in fair value	(45)	(45)
Balance at end of period	$1,452	$1,452

The following table presents the components of servicing revenue recorded within other income on the Company's condensed consolidated statements of comprehensive (loss) income for the three and six months ended June 30, 2013:

(in thousands)	Three Months Ended June 30, 2013	Six Months Ended June 30, 2013
Servicing fee income	$215	$215
Ancillary fee income	30	30
	$245	$245

Note 14. Other Liabilities
Other liabilities as of June 30, 2013 and December 31, 2012 are summarized in the following table:

(in thousands)	June 30, 2013	December 31, 2012
Accrued expenses	$12,043	$13,295
Deferred tax liabilities	8,508	—
Income taxes payable	1,320	—
Other	1,631	—
Total other liabilities	$23,502	$13,295

Note 15. Fair Value
Fair Value Measurements
ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820 clarifies that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The fair value hierarchy gives the highest priority to quoted prices available in active markets (i.e., observable inputs) and the lowest priority to data lacking transparency (i.e., unobservable inputs). Additionally, ASC 820 requires an entity to consider all aspects of nonperformance risk, including the entity's own credit standing, when measuring fair value of a liability.
ASC 820 establishes a three level hierarchy to be used when measuring and disclosing fair value. An instrument's categorization within the fair value hierarchy is based on the lowest level of significant input to its valuation. Following is a description of the three levels:

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Level 1	Inputs are quoted prices in active markets for identical assets or liabilities as of the measurement date under current market conditions. Additionally, the entity must have the ability to access the active market and the quoted prices cannot be adjusted by the entity.
Level 2	Inputs include quoted prices in active markets for similar assets or liabilities; quoted prices in inactive markets for identical or similar assets or liabilities; or inputs that are observable or can be corroborated by observable market data by correlation or other means for substantially the full-term of the assets or liabilities.
Level 3	Unobservable inputs are supported by little or no market activity. The unobservable inputs represent the assumptions that market participants would use to price the assets and liabilities, including risk. Generally, Level 3 assets and liabilities are valued using pricing models, discounted cash flow methodologies, or similar techniques that require significant judgment or estimation.

Following are descriptions of the valuation methodologies used to measure material assets and liabilities at fair value and details of the valuation models, key inputs to those models and significant assumptions utilized.

Investment securities - The Company holds a portfolio of AFS and trading securities that are carried at fair value in the condensed consolidated balance sheet. AFS securities are primarily comprised of Agency and non-Agency RMBS while the Company's U.S. Treasuries are classified as trading securities. The Company determines the fair value of its U.S. Treasuries and Agency RMBS based upon prices obtained from third-party pricing providers or broker quotes received using bid price, which are deemed indicative of market activity. In determining the fair value of its non-Agency RMBS, management judgment is used to arrive at fair value that considers prices obtained from third-party pricing providers, broker quotes received and other applicable market data. If observable market prices are not available or insufficient to determine fair value due to principally illiquidity in the marketplace, then fair value is based upon internally developed models that are primarily based on observable market-based inputs but also include unobservable market data inputs (including prepayment speeds, delinquency levels, and credit losses). The Company classified 100% of its U.S. Treasuries as Level 1 fair value assets at June 30, 2013. The Company classified 100% of its RMBS AFS securities reported at fair value as Level 2 at June 30, 2013. AFS and trading securities account for 82.9% and 5.6%, respectively, of all assets reported at fair value at June 30, 2013.

Equity securities - The Company held shares of Silver Bay common stock at December 31, 2012 that were carried at fair value in the condensed consolidated balance sheet as a result of a fair value option election. The Company determined fair value of these equity securities based on the closing market price at period end. As the shares were distributed to Two Harbors stockholders in 2013, equity securities are no longer recognized on the condensed consolidated balance sheet as of June 30, 2013.

Mortgage loans held-for-sale - The Company holds a portfolio of mortgage loans held-for-sale that are carried at fair value in the condensed consolidated balance sheet as a result of a fair value option election. The Company determines fair value of its mortgage loans based on prices obtained from third-party pricing providers and other applicable market data. If observable market prices are not available or insufficient to determine fair value due principally to illiquidity in the marketplace, then fair value is based upon cash flow models that are primarily based on observable market-based inputs but also include unobservable market data inputs (including prepayment speeds, delinquency levels and credit losses). The Company classified 54.3% and 45.7% of its mortgage loans held-for-sale as Level 2 and Level 3 fair value assets, respectively, at June 30, 2013.

Mortgage loans held-for-investment in securitization trust - The Company recognizes on its condensed consolidated balance sheet mortgage loans held-for-investment in securitization trust that are carried at fair value as a result of a fair value option election. The Company determines fair value of its mortgage loans based on prices obtained from third-party pricing providers and other applicable market data. If observable market prices are not available or insufficient to determine fair value due principally to illiquidity in the marketplace, then fair value is based upon cash flow models that are primarily based on observable market-based inputs but also include unobservable market data inputs (including prepayment speeds, delinquency levels and credit losses). The Company classified 100% of its

mortgage loans held-for-investment in securitization trust as Level 2 fair value assets at June 30, 2013.
Mortgage servicing rights - The Company holds a portfolio of MSRs that are carried at fair value and included in other assets on the condensed consolidated balance sheet. As there are limited MSR transactions that are directly observable in the market, the Company determines fair value of its MSRs based upon cash flow models that are primarily based on observable market-based inputs but also include unobservable market data inputs (including prepayment speeds, delinquency levels and discount rates). The Company classified 100% of its MSRs as Level 3 fair value assets at June 30, 2013.
Derivative instruments - The Company may enter into a variety of derivative financial instruments as part of its hedging strategies. The Company principally executes over-the-counter, or OTC, derivative contracts, such as interest rate swaps,

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swaptions, and credit default swaps. The Company utilizes third-party pricing providers to value its financial derivative instruments. The Company classified 100% of the interest rate swaps, swaptions and credit default swaps reported at fair value as Level 2 at June 30, 2013.

The Company also enters into certain other derivative financial instruments, such as TBAs and inverse interest-only securities. These instruments are similar in form to the Company's AFS securities and the Company utilizes a pricing service for TBAs and broker quotes for inverse interest-only securities to value these instruments. The Company classified 100% of its inverse interest-only securities at fair value as Level 2 at June 30, 2013. The Company reported 100% of its TBAs as Level 1 as of June 30, 2013.

The Company may also enter into forward purchase commitments on mortgage loans whereby the Company commits to purchasing the loans at a particular interest rate. The fair value of these derivatives is determined based on prices obtained from third-party price providers. Fallout assumptions if the borrower elects not to close the loan are applied to the third-party pricing. The Company classified 100% of its forward purchase commitments at fair value as Level 2 at June 30, 2013.

The Company's risk management committee governs trading activity relating to derivative instruments. The Company's policy is to minimize credit exposure related to financial derivatives used for hedging by limiting the hedge counterparties to major banks, financial institutions, exchanges, and private investors who meet established capital and credit guidelines as well as by limiting the amount of exposure to any individual counterparty.

The Company has netting arrangements in place with all derivative counterparties pursuant to standard documentation developed by the International Swap and Derivatives Association, or ISDA. Additionally, both the Company and the counterparty are required to post cash collateral based upon the net underlying market value of the Company's open positions with the counterparty. Posting of cash collateral typically occurs daily, subject to certain dollar thresholds. Due to the existence of netting arrangements, as well as frequent cash collateral posting at low posting thresholds, credit exposure to the Company and/or to the counterparty is considered materially mitigated. Based on the Company's assessment, there is no requirement for any additional adjustment to derivative valuations specifically for credit.

Collateralized borrowings in securitization trust - The Company recognizes on its condensed consolidated balance sheet collateralized borrowings that are carried at fair value as a result of a fair value option election. The Company determines fair value of its collateralized borrowings based on prices obtained from third-party pricing providers, broker quotes received and other applicable market data. If observable market prices are not available or insufficient to determine fair value due to principally illiquidity in the marketplace, then fair value is based upon internally developed models that are primarily based on observable market-based inputs but also include unobservable market data inputs (including prepayment speeds, delinquency levels, and credit losses). The Company classified 100% of its collateralized borrowings in securitization trust as Level 2 fair value assets at June 30, 2013.

The following tables display the Company's assets and liabilities measured at fair value on a recurring basis. The Company often economically hedges the fair value change of its assets or liabilities with derivatives and other financial instruments. The tables below display the hedges separately from the hedged items, and therefore do not directly display the impact of the Company's risk management activities.

	Recurring Fair Value Measurements At June 30, 2013			
(in thousands)	Level 1	Level 2	Level 3	Total
Assets				
Available-for-sale securities	$—	$14,892,315	$—	$14,892,315
Trading securities	1,001,172	—	—	1,001,172
Mortgage loans held-for-sale	—	520,008	438,193	958,201
Mortgage loans held-for-investment in securitization trust	—	401,347	—	401,347

Derivative assets	61,156	638,195	—	699,351
Mortgage servicing rights	—	—	1,452	1,452
Total assets	$1,062,328	$16,451,865	$439,645	$17,953,838
Liabilities				
Collateralized borrowings in securitization trust	$—	$363,012	$—	$363,012
Derivative liabilities	22,568	23,460	—	46,028
Total liabilities	$22,568	$386,472	$—	$409,040

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	Recurring Fair Value Measurements At December 31, 2012			
(in thousands)	Level 1	Level 2	Level 3	Total
Assets				
Available-for-sale securities	$—	$13,665,083	$1,871	$13,666,954
Trading securities	1,002,062	—	—	1,002,062
Equity securities	335,638	—	—	335,638
Mortgage loans held-for-sale	—	58,607	—	58,607
Derivative assets	1,917	460,163	—	462,080
Total assets	$1,339,617	$14,183,853	$1,871	$15,525,341
Liabilities				
Derivative liabilities	$239	$129,055	$—	$129,294
Total liabilities	$239	$129,055	$—	$129,294

The Company may be required to measure certain assets or liabilities at fair value from time to time. These periodic fair value measures typically result from application of certain impairment measures under GAAP. These items would constitute nonrecurring fair value measures under ASC 820. As of June 30, 2013, the Company did not have any assets or liabilities measured at fair value on a nonrecurring basis in the periods presented.

The valuation of Level 3 instruments requires significant judgment by the third-party pricing providers and/or management. The third party pricing providers and/or management rely on inputs such as market price quotations from market makers (either market or indicative levels), original transaction price, recent transactions in the same or similar instruments, and changes in financial ratios or cash flows to determine fair value. Level 3 instruments may also be discounted to reflect illiquidity and/or non-transferability, with the amount of such discount estimated by the third party pricing provider in the absence of market information. Assumptions used by the third party pricing provider due to lack of observable inputs may significantly impact the resulting fair value and therefore the Company's financial statements. The Company's valuation committee reviews all valuations that are based on pricing information received from a third-party pricing provider. As part of this review, prices are compared against other pricing or input data points in the marketplace, along with internal valuation expertise, to ensure the pricing is reasonable. In addition, the Company performs back-testing of pricing information to validate price information and identify any pricing trends of a third party price provider.

In determining fair value, third party pricing providers use various valuation approaches, including market and income approaches. Inputs that are used in determining fair value of an instrument may include pricing information, credit data, volatility statistics, and other factors. In addition, inputs can be either observable or unobservable.

The availability of observable inputs can vary by instrument and is affected by a wide variety of factors, including the type of instrument, whether the instrument is new and not yet established in the marketplace and other characteristics particular to the instrument. The third party pricing provider uses prices and inputs that are current as of the measurement date, including during periods of market dislocations. In periods of market dislocation, the availability of prices and inputs may be reduced for many instruments. This condition could cause an instrument to be reclassified to or from various levels within the fair value hierarchy.

Securities for which market quotations are readily available are valued at the bid price (in the case of long positions) or the ask price (in the case of short positions) at the close of trading on the date as of which value is determined. Exchange-traded securities for which no bid or ask price is available are valued at the last traded price. OTC derivative contracts, including interest rate swaps, swaptions, and credit default swaps, are valued by the Company using observable inputs, specifically quotations received from third-party pricing providers, and are therefore classified within Level 2.

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The table below presents the reconciliation for all of the Company's Level 3 assets and liabilities measured at fair value on a recurring basis. The Level 3 items presented below may be hedged by derivatives and other financial instruments that are classified as Level 1 or Level 2. Thus, the tables below do not fully reflect the impact of the Company's risk management activities.

	Level 3 Recurring Fair Value Measurements Three Months Ended June 30, 2013		
	Assets		
(in thousands)	Available-For-Sale Securities	Mortgage Loans Held-For-Sale	Mortgage Servicing Rights
Beginning of period level 3 fair value	$4,500	$123,235	$—
Gains/(losses) included in net income:			
Realized gains (losses)	— [1]	422	—
Unrealized gains (losses)	—	(12,749) [2]	(45)
Total net gains/(losses) included in net income	—	(12,327)	(45)
Other comprehensive income	—	—	—
Purchases	—	330,583	1,497
Sales	—	—	—
Settlements	—	(3,298)	—
Gross transfers into level 3	—	—	—
Gross transfers out of level 3	(4,500)	—	—
End of period level 3 fair value	$—	$438,193	$1,452
Change in unrealized gains or losses for the period included in earnings for assets held at the end of the reporting period	$—	$(12,749) [3]	$—

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(in thousands)	Level 3 Recurring Fair Value Measurements Six Months Ended June 30, 2013 Assets Available-For-Sale Securities	Mortgage Loans Held-For-Sale	Mortgage Servicing Rights
Beginning of period level 3 fair value	$1,871	$—	$—
Gains/(losses) included in net income:			
Realized gains (losses)	74 [1]	422	—
Unrealized gains (losses)	—	1,174 [2]	(45)
Total net gains/(losses) included in net income	74	1,596	(45)
Other comprehensive income	1,426	—	—
Purchases	—	440,067	1,497
Sales	—	—	—
Settlements	—	(3,470)	—
Gross transfers into level 3	3,000	—	—
Gross transfers out of level 3	(6,371)	—	—
End of period level 3 fair value	$—	$438,193	$1,452
Change in unrealized gains or losses for the period included in earnings for assets held at the end of the reporting period	$—	$1,174 [3]	$—

(1) For the three and six months ended June 30, 2013, the realized gains on available-for-sale securities represent net (premium amortization)/discount accretion recorded in interest income on the condensed consolidated statements of comprehensive (loss) income.

(2) For the three and six months ended June 30, 2013, the change in unrealized gains or losses on mortgage loans held-for-sale was recorded in (loss) gain on mortgage loans held-for-sale on the condensed consolidated statements of comprehensive (loss) income.

(3) For the three and six months ended June 30, 2013, the change in unrealized gains or losses on mortgage loans held-for-sale that were held at the end of the reporting period were recorded in (loss) gain on mortgage loans held-for-sale on the condensed consolidated statements of comprehensive (loss) income.

The Company transferred one Level 2 asset in the amount of $3.0 million into Level 3 during the three months ended March 31, 2013. The asset was deemed to be Level 3 based on the limited availability of third-party pricing. However, during the six months ended June 30, 2013, the Company transferred this asset along with two other Level 3 assets in the amount of $6.4 million into Level 2. The assets were deemed to be Level 2 based on the availability of third-party pricing and corroborating market data. The Company did not incur transfers between Level 1 and Level 2 for the six months ended June 30, 2013. Transfers between Levels are deemed to take place on the first day of the reporting period in which the transfer has taken place.
The Company used a third party pricing provider in the fair value measurement of its Level 3 mortgage loans held-for-sale. The significant unobservable inputs used by the third party pricing provider included expected default, severity and discount rate. Significant increases (decreases) in any of the inputs in isolation may result in significantly lower (higher) fair value measurement.

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The table below presents information about the significant unobservable inputs used in the fair value measurement of the Company's MSRs classified as Level 3 fair value assets at June 30, 2013:

	As of June 30, 2013			
(in thousands)	Fair Value	Valuation Technique	Unobservable Input [1]	Input Range
Mortgage servicing rights:				
	$1,452	Discounted cash flow	Constant prepayment speed	3 - 6 %
			Delinquency	8 - 15 %
			Discount rate	10 - 15 %

(1) Significant increases/(decreases) in any of the inputs in isolation may result in significantly lower/(higher) fair value measurement. A change in the assumption used for the probability of default may be accompanied by a directionally similar change in the assumption used for the loss severity and a directionally opposite change in the assumption used for prepayment rates.

Fair Value Option for Financial Assets and Financial Liabilities
The Company elected the fair value option for the residential mortgage loans it acquired. The fair value option was elected to mitigate earnings volatility by better matching the accounting for the assets with the related hedges. The residential mortgage loans are carried within mortgage loans held-for-sale on the condensed consolidated balance sheet. The Company's policy is to separately record interest income on these fair value elected loans. Upfront fees and costs related to the fair value elected loans are not deferred or capitalized. Fair value adjustments are reported in gain (loss) on mortgage loans held-for-sale on the condensed consolidated statements of comprehensive (loss) income. The fair value option is irrevocable once the loan is acquired.
The Company elected the fair value option for the equity securities carried on the condensed consolidated balance sheet at December 31, 2012, which consist solely of shares of Silver Bay common stock. The Company determined fair value of these equity securities based on the closing market price at period end. Fair value adjustments are reported in gain on investment securities on the condensed consolidated statements of comprehensive (loss) income.
The Company also elected the fair value option for both the mortgage loans held-for-investment in securitization trust and the collateralized borrowings in securitization trust carried on the condensed consolidated balance sheet. The fair value option was elected to better reflect the economics of the Company's retained interests. The Company's policy is to separately record interest income on the fair value elected loans and interest expense on the fair value elected borrowings. Upfront fees and costs are not deferred or capitalized. Fair value adjustments are reported in other income n the condensed consolidated statements of comprehensive (loss) income.

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The following table summarizes the fair value option elections and information regarding the amounts recognized in earnings for each fair value option-elected item.

	Changes included in the Condensed Consolidated Statements of Comprehensive (Loss) Income			
	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
(in thousands)				
Interest income:				
Interest income on mortgage loans held-for-sale [1]	$4,794	$126	$6,112	$195
Interest income on mortgage loans held-for-investment in securitization trust [1]	4,369	—	6,023	—
Interest expense:				
Interest expense on collateralized borrowings in securitization trust	(2,169)	—	(2,987)	—
Other income:				
Realized gain (loss) on mortgage loans held-for-sale [2]	297	(22)	235	(22)
Unrealized gain (loss) on mortgage loans held-for-sale [2]	(15,137)	70	(1,039)	26
Unrealized loss on mortgage loans held-for-investment in securitization trust [3]	(16,755)	—	(24,757)	—
Unrealized gain on collateralized borrowings in securitization trust [3]	18,313	—	32,604	—
Realized gain on equity securities [4]	13,725	—	13,725	—
Unrealized loss on equity securities [4]	(13,725)	—	(5,882)	—
Total included in net income	$(6,288)	$174	$24,034	$199
Change in fair value due to credit risk	$—	$—	$—	$—

(1) Interest income on mortgage loans held-for-sale and mortgage loans held-for-investment in securitization trust is measured by multiplying the unpaid principal balance on the loans by the coupon rate and the number of days of interest due.

(2) Realized gain (loss) and unrealized (loss) gain on mortgage loans held-for-sale is recorded in (loss) gain on mortgage loans held-for-sale on the condensed consolidated statements of comprehensive (loss) income.

(3) Unrealized losses on mortgage loans held-for-investment in securitization trust and unrealized gains on collateralized borrowings in securitization trust are recorded in other income on the condensed consolidated statements of comprehensive (loss) income.

(4) Realized gains and unrealized losses on equity securities are recorded in gain on investment securities on the condensed consolidated statements of comprehensive (loss) income.

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The table below provides the fair value and the unpaid principal balance for the Company's fair value option-elected loans and collateralized borrowings.

(in thousands)	June 30, 2013 Unpaid Principal Balance	Fair Value [1]	December 31, 2012 Unpaid Principal Balance	Fair Value [1]
Mortgage loans held-for-sale				
Total loans	$1,101,388	$958,201	$56,976	$58,607
Nonaccrual loans	$49,468	$28,889	$—	$—
Loans 90+ days past due	$30,408	$18,090	$—	$—
Mortgage loans held-for-investment in securitization trust				
Total loans	$405,519	$401,347	$—	$—
Nonaccrual loans	$—	$—	$—	$—
Loans 90+ days past due	$—	$—	$—	$—
Collateralized borrowings in securitization trust				
Total borrowings	$391,458	$363,012	$—	$—

(1) Excludes accrued interest receivable.

Fair Value of Financial Instruments

In accordance with ASC 820, the Company is required to disclose the fair value of financial instruments, both assets and liabilities recognized and not recognized in the condensed consolidated balance sheet, for which fair value can be estimated.

The following describes the Company's methods for estimating the fair value for financial instruments. Descriptions are not provided for those items that have zero balances as of the current balance sheet date.

- AFS securities, trading securities, equity securities, mortgage loans held-for-sale, mortgage loans held-for-investment in securitization trust, MSRs, derivative assets and liabilities, and collateralized borrowings in securitization trust are recurring fair value measurements; carrying value equals fair value. See discussion of valuation methods and assumptions within the Fair Value Measurements section of this footnote.
- Cash and cash equivalents and restricted cash have a carrying value which approximates fair value because of the short maturities of these instruments. The Company categorizes the fair value measurement of these assets as Level 1.
- The carrying value of repurchase agreements that mature in less than one year generally approximates fair value due to the short maturities. The Company holds $200.0 million of repurchase agreements that are considered long-term. The Company's long-term repurchase agreements have floating rates based on an index plus a spread and the credit spread is typically consistent with those demanded in the market. Accordingly, the interest rates on these borrowings are at market and thus carrying value approximates fair value. The Company categorizes the fair value measurement of these liabilities as Level 1.

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The following table presents the carrying values and estimated fair values of assets and liabilities that are required to be recorded or disclosed at fair value at June 30, 2013 and December 31, 2012.

	June 30, 2013		December 31, 2012	
(in thousands)	Carrying Value	Fair Value	Carrying Value	Fair Value
Assets				
Available-for-sale securities	$14,892,315	$14,892,315	$13,666,954	$13,666,954
Trading securities	1,001,172	1,001,172	1,002,062	1,002,062
Equity securities	—	—	335,638	335,638
Mortgage loans held-for-sale	958,201	958,201	58,607	58,607
Mortgage loans held-for-investment in securitization trust	401,347	401,347	—	—
Cash and cash equivalents	917,224	917,224	821,108	821,108
Restricted cash	685,965	685,965	302,322	302,322
Derivative assets	699,351	699,351	462,080	462,080
Mortgage servicing rights	1,452	1,452	—	—
Liabilities				
Repurchase agreements	$14,903,155	$14,903,155	$12,624,510	$12,624,510
Collateralized borrowings in securitization trust	363,012	363,012	—	—
Derivative liabilities	46,028	46,028	129,294	129,294

Note 16. Repurchase Agreements
The Company had outstanding $14.9 billion of repurchase agreements, including repurchase agreements funding the Company's U.S. Treasuries of $1.0 billion. Excluding the debt associated with the Company's U.S. Treasuries and the effect of the Company's interest rate swaps, the repurchase agreements had a weighted average borrowing rate of 0.72% and weighted average remaining maturities of 86 days as of June 30, 2013. The Company had outstanding $12.6 billion of repurchase agreements with a weighted average borrowing rate of 0.76%, excluding the debt associated with the Company's U.S. Treasuries and the effect of the Company's interest rate swaps, and weighted average remaining maturities of 85 days as of December 31, 2012. As of June 30, 2013 and December 31, 2012, the debt associated with the Company's U.S. Treasuries had a weighted average borrowing rate of 0.08% and 0.30%, respectively.
At June 30, 2013 and December 31, 2012, the repurchase agreement balances were as follows:

(in thousands)	June 30, 2013	December 31, 2012
Short-term	$14,703,155	$12,424,510
Long-term	200,000	200,000
Total	$14,903,155	$12,624,510

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At June 30, 2013 and December 31, 2012, the repurchase agreements had the following characteristics:

(dollars in thousands)	June 30, 2013		December 31, 2012	
Collateral Type	Amount Outstanding	Weighted Average Borrowing Rate	Amount Outstanding	Weighted Average Borrowing Rate
U.S. Treasuries	$1,000,000	0.08 %	$997,500	0.30 %
Agency RMBS AFS	11,828,514	0.46 %	10,171,385	0.54 %
Non-Agency RMBS	1,421,285	2.23 %	1,177,675	2.50 %
Agency derivatives	219,235	1.07 %	228,241	1.16 %
Mortgage loans held-for-sale	434,121	2.69 %	49,709	2.46 %
Total	$14,903,155	0.67 %	$12,624,510	0.72 %

At June 30, 2013 and December 31, 2012, the repurchase agreements had the following remaining maturities:

(in thousands)	June 30, 2013	December 31, 2012
Within 30 days	$4,751,482	$3,038,229
30 to 59 days	2,937,677	3,528,393
60 to 89 days	889,141	1,731,595
90 to 119 days	1,553,211	849,621
120 to 364 days	3,571,644	2,279,172
Open maturity (1)	1,000,000	997,500
One year and over (2)	200,000	200,000
Total	$14,903,155	$12,624,510

(1) Repurchase agreements collateralized by U.S. Treasuries include an open maturity period (i.e., rolling 1-day maturity) renewable at the discretion of either party to the agreements.
(2) One year and over includes repurchase agreements with maturity dates ranging from June 26, 2015 to July 27, 2016.

The following table summarizes assets at carrying value that are pledged or restricted as collateral for the future payment obligations of repurchase agreements:

(in thousands)	June 30, 2013	December 31, 2012
Available-for-sale securities, at fair value	$14,153,148	$12,810,355
Trading securities, at fair value	1,001,172	1,002,062
Mortgage loans held-for-sale	475,028	52,529
Cash and cash equivalents	15,000	10,000
Restricted cash	596,479	84,307
Due from counterparties	15,373	36,917
Derivative assets, at fair value	239,293	291,054
Total	$16,495,493	$14,287,224

Although the transactions under repurchase agreements represent committed borrowings until maturity, 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.

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The following table summarizes certain characteristics of the Company's repurchase agreements and counterparty concentration at June 30, 2013 and December 31, 2012:

	June 30, 2013				December 31, 2012			
(dollars in thousands)	Amount Outstanding	Net Counterparty Exposure (1)	Percent of Equity	Weighted Average Days to Maturity	Amount Outstanding	Net Counterparty Exposure (1)	Percent of Equity	Weighted Average Days to Maturity
Barclays Capital Inc.	$1,408,599	$240,632	6 %	64.6	$1,127,888	$257,858	7 %	90.3
All other counterparties (2) (3)	12,494,556	1,345,743	35 %	88.6	10,499,122	1,403,268	41 %	84.0
Total	$13,903,155	$1,586,375			$11,627,010	$1,661,126		

(1) Represents the net carrying value of the securities sold under agreements to repurchase, including accrued interest plus any cash or assets on deposit to secure the repurchase obligation, less the amount of the repurchase liability, including accrued interest. At June 30, 2013 and December 31, 2012, the Company had $62.8 million and $291.7 million, respectively, in payables due to broker counterparties for unsettled securities purchases. The payables are not included in the amounts presented above.
(2) Excludes $1.0 billion of repurchase agreements collateralized by U.S. Treasuries with a rolling 1-day maturity.
(3) Represents amounts outstanding to 19 and 21 counterparties at June 30, 2013 and December 31, 2012, respectively.

The Company does not anticipate any defaults by its repurchase agreement counterparties.

Note 17. Collateralized Borrowings in Securitization Trust, at Fair Value

During the six months ended June 30, 2013, the Company purchased subordinated debt and excess servicing rights from a securitization trust issued by a third party. The debt associated with the underlying residential mortgage loans held at the trust, which is consolidated on the Company's condensed consolidated balance sheet, is classified as collateralized borrowings in securitization trust and carried at fair value as a result of a fair value option election. See Note 3 - Variable Interest Entities for additional information regarding consolidation of the securitization trust. As of June 30, 2013, the collateralized borrowings in securitization trust had a carrying value of $363.0 million with a weighted average interest rate of 2.19%. The stated maturity dates for all collateralized borrowings are greater than five years from June 30, 2013. No collateralized borrowings were outstanding as of December 31, 2012.

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Note 18. Stockholders' Equity
Distributions to Stockholders
The following table presents cash dividends declared by the Company on its common stock from October 28, 2009 through June 30, 2013:

Declaration Date	Record Date	Payment Date	Cash Dividend Per Share
June 18, 2013	June 28, 2013	July 23, 2013	$0.31
March 18, 2013	April 2, 2013	April 24, 2013	$0.32
December 17, 2012	December 31, 2012	January 18, 2013	$0.55
September 12, 2012	September 24, 2012	October 22, 2012	$0.36
June 12, 2012	June 22, 2012	July 20, 2012	$0.40
March 14, 2012	March 26, 2012	April 20, 2012	$0.40
December 14, 2011	December 27, 2011	January 20, 2012	$0.40
September 14, 2011	September 26, 2011	October 20, 2011	$0.40
June 14, 2011	June 24, 2011	July 20, 2011	$0.40
March 2, 2011	March 14, 2011	April 14, 2011	$0.40
December 8, 2010	December 17, 2010	January 20, 2011	$0.40
September 13, 2010	September 30, 2010	October 21, 2010	$0.39
June 14, 2010	June 30, 2010	July 22, 2010	$0.33
March 12, 2010	March 31, 2010	April 23, 2010	$0.36
December 21, 2009	December 31, 2009	January 26, 2010	$0.26

Special Dividend of Silver Bay Common Stock
On March 18, 2013, the Company's board of directors declared a special dividend pursuant to which the 17,824,647 shares of Silver Bay common stock the Company received in exchange for the contribution of its equity interests in Two Harbors Property Investment LLC to Silver Bay on December 19, 2012 would be distributed, on a pro rata basis, to Two Harbors stockholders of record at the close of business on April 2, 2013. The final distribution ratio for the stock dividend was determined to be 0.048825853 shares of Silver Bay common stock for each share of the Company's common stock outstanding as of April 2, 2013. The dividend was payable on or about April 24, 2013.
Accumulated Other Comprehensive Income
Accumulated other comprehensive income at June 30, 2013 and December 31, 2012 was as follows:

(in thousands)	June 30, 2013	December 31, 2012
Available-for-sale securities, at fair value		
Unrealized gains	$678,622	$724,696
Unrealized losses	(412,625)	(28,238)
Accumulated other comprehensive income	$265,997	$696,458

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Reclassifications out of Accumulated Other Comprehensive Income

The following table summarizes reclassifications out of accumulated other comprehensive income for the three and six months ended June 30, 2013 and 2012:

(in thousands)	Affected Line Item in the Condensed Consolidated Statements of Comprehensive (Loss) Income	Amount Reclassified out of Accumulated Other Comprehensive Income			
		Three Months Ended June 30,		Six Months Ended June 30,	
		2013	2012	2013	2012
Other-than-temporary-impairments on AFS securities	Total other-than-temporary impairment losses	$1,426	$4,476	$1,662	$8,751
Realized (gains) losses on sales of AFS securities	Gain on investment securities	(45,143)	2,846	(63,918)	(7,145)
		$(43,717)	$7,322	$(62,256)	$1,606

Public Offering

On March 22, 2013, the Company completed a public offering of 50,000,000 shares of its common stock and issued an additional 7,500,000 shares of common stock pursuant to the underwriters' over-allotments at a price of $13.46 per share, for gross proceeds of approximately $774.0 million. Net proceeds to the Company were approximately $762.9 million, net of issuance costs of approximately $11.1 million.

Dividend Reinvestment and Direct Stock Purchase Plan

The Company sponsors a dividend reinvestment and direct stock purchase plan through which stockholders may purchase additional shares of the Company's common stock by reinvesting some or all of the cash dividends received on shares of the Company's common stock. Stockholders may also make optional cash purchases of shares of the Company's common stock subject to certain limitation detailed in the plan prospectus. An aggregate of 7.5 million shares of our common stock were originally reserved for issuance under the plan. As of June 30, 2013, 125,951 shares have been issued under the plan for total proceeds of $1.4 million.

Share Repurchase Program

On October 5, 2011, the Company's Board of Directors authorized a share repurchase program, which allows the Company to repurchase up to 10,000,000 shares of its common stock. On November 14, 2012, the Board of Directors authorized an increase in the share repurchase program of 15,000,000, for a total of 25,000,000 shares. Shares may be repurchased from time to time through privately negotiated transactions or open market transactions, pursuant to a trading plan in accordance with Rules 10b5-1 and 10b-18 under the Exchange Act or by any combination of such methods. The manner, price, number and timing of share repurchases will be subject to a variety of factors, including market conditions and applicable SEC rules. As of June 30, 2013, 1,000,000 shares had been repurchased by the Company under the program for a total cost of $10.5 million.

At-the-Market Offering

On May 25, 2012, the Company entered into an equity distribution agreement under which the Company may sell up to an aggregate of 20,000,000 shares of its common stock from time to time in any method permitted by law deemed to be an “at the market” offering as defined in Rule 415 under the Securities Act. As of June 30, 2013, 7,585,869 shares of common stock have been sold under the equity distribution agreement for total accumulated net proceeds of approximately $77.6 million; however, no shares were sold during the six months ended June 30, 2013.

Warrants

From January 1, 2013 to April 2, 2013, warrantholders exercised 8,720,690 warrants to purchase 8,720,690 shares of the Company's common stock, at an exercise price of $11.00 per share.

On April 2, 2013, the exercise price of the warrants was lowered to $10.25 per warrant share and the number of shares of the Company's common stock issuable for each warrant share exercised was increased to 1.0727 shares. These adjustments were required under the terms of the warrant agreement as a result of the special dividend of Silver Bay common stock. Calculation of the adjustments was determined based on, among other things, the closing price of the Company's common

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stock on the business day immediately preceding the ex-dividend date for the stock dividend and the fair market value of the stock dividend to be received for each share of the Company's common stock on the ex-dividend date.
From April 3, 2013 to June 30, 2013, warrantholders exercised 554,390 warrants to purchase 594,664 shares of the Company's common stock, at an exercise price of $10.25 per share. Total proceeds to the Company for warrant exercises during the six months ended June 30, 2013 were approximately $101.6 million.
Additionally, certain Capitol founders holding warrants containing cashless exercise provisions exercised 100,000 warrants on a cashless basis, resulting in the surrender of 93,649 shares of common stock and the issuance of 6,351 shares of common stock during the six months ended June 30, 2013. No proceeds were received by the Company as a result of the cashless exercises.
As of June 30, 2013, 4,156,349 warrants to purchase approximately 4,458,515 shares of common stock remained outstanding.

Note 19. Equity Incentive Plan
In 2009, the Company adopted an equity incentive plan which provides incentive compensation to attract and retain qualified directors, officers, advisors, consultants and other personnel, including PRCM Advisers and affiliates and personnel of PRCM Advisers and its affiliates, and any joint venture affiliates of the Company.
On May 21, 2013, the Company's stockholders approved the restated 2009 equity incentive plan, which effectuated, among other changes, an increase in the number of shares available for issuance under the plan by 2,800,000 shares of common stock from 200,000 to 3,000,000 shares of common stock. Other amendments provide for the possibility of making grants of equity-based compensation to the Company's executive officers and other key employees of PRCM Advisers upon a determination by the compensation committee, and the implementation of certain best practices of equity-based compensation.
The restated 2009 equity incentive plan is administered by the compensation committee of the Company's board of directors. The compensation committee has the full authority to administer and interpret the restated 2009 equity incentive plan, to authorize the granting of awards, to determine the eligibility of directors, officers, advisors, consultants and other personnel, including PRCM Advisers and affiliates and personnel of PRCM Advisers and its affiliates, and any joint venture affiliates of the Company, to receive an award, to determine the number of shares of common stock to be covered by each award (subject to the individual participant limitations provided in the restated 2009 equity incentive plan), to determine the terms, provisions and conditions of each award (which may not be inconsistent with the terms of the restated 2009 equity incentive plan), to prescribe the form of instruments evidencing awards and to take any other actions and make all other determinations that it deems necessary or appropriate in connection with the restated 2009 equity incentive plan or the administration or interpretation thereof. In connection with this authority, the compensation committee may, among other things, establish performance goals that must be met in order for awards to be granted or to vest, or for the restrictions on any such awards to lapse.
The Company's restated 2009 equity incentive plan provides for grants of restricted common stock, phantom shares, dividend equivalent rights and other equity-based awards, subject to a ceiling of 3,000,000 shares available for issuance under the plan. The plan allows for the Company's board of directors to expand the types of awards available under the plan to include long-term incentive plan units in the future. The maximum number of shares with respect to which any options may be granted in any one year to any eligible person may not exceed 500,000. The maximum number of shares that may underlie grants, other than grants of options, in any one year to any eligible person may not exceed 200,000. If an award granted under the restated 2009 equity incentive plan expires or terminates, the shares subject to any portion of the award that expires or terminates without having been exercised or paid, as the case may be, will again become available for the issuance of additional awards. Unless previously terminated by the Company's board of directors, no new award may be granted under the restated 2009 equity incentive plan after the tenth anniversary of the date that such plan was initially approved by the Company's board of directors. No award may be granted under the restated 2009 equity incentive plan to any person who, assuming payment of all awards held by

such person, would own or be deemed to own more than 9.8% of the outstanding shares of the Company's common stock.

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On May 23, 2012 and May 21, 2013, the Company granted 32,021 and 36,335 shares of restricted common stock, respectively, to its independent directors pursuant to the 2009 equity incentive plan. The estimated fair value of these awards was $10.15 and $11.56 per share, respectively, based on the closing price of the Company's common stock on such date. The grants vested immediately. Additionally, on May 29, 2013, the Company granted 1,020,969 shares of restricted common stock to its executive officers and other key employees of PRCM Advisers pursuant to the restated 2009 equity incentive plan. The estimated fair value of these awards was $11.23 per share on grant date, May 29, 2013, based on the closing price of the Company's common stock on such date. However, as the cost of these awards is determined using fair value liability accounting in accordance with ASC 718, the fair value of these awards as of June 30, 2013 is $10.25 per share based on the closing price of the Company's common stock on such date. The grants will vest in three annual installments commencing on the date of the grant, as long as such individual is employed on the vesting date.

For the three and six months ended June 30, 2013, the Company recognized compensation costs related to restricted stock of $975,331 and $998,768, respectively. For the three and six months ended June 30, 2012, the Company recognized compensation costs related to restricted stock of $373,276 and $433,346, respectively.

Note 20. Other Operating Expenses

Components of the Company's other operating expenses for the three and six months ended June 30, 2013 and 2012, are presented in the following table:

	Three Months Ended June 30,		Six Months Ended June 30,	
(in thousands)	2013	2012	2013	2012
Other operating expenses:				
General and administrative	$7,603	$3,311	$12,315	$6,372
Directors and officers' insurance	201	175	402	289
Professional fees	1,375	433	3,023	809
Subservicing expenses	307	—	307	—
Total other operating expenses	$9,486	$3,919	$16,047	$7,470

Note 21. Income Taxes

For the three and six months ended June 30, 2013 and 2012, the Company qualified to be taxed as a REIT under the Code for U.S. federal income tax purposes. As long as the Company qualifies as a REIT, the Company generally will not be subject to U.S. federal income taxes on its taxable income to the extent it annually distributes its net taxable income to stockholders, does not engage in prohibited transactions, and maintains its intended qualification as a REIT. The majority of states also recognize the Company's REIT status. The Company's TRSs file separate tax returns and are fully taxed as standalone U.S. C-Corporations. It is assumed that the Company will retain its REIT status and will incur no REIT level taxation as it intends to comply with the REIT regulations and annual distribution requirements. During the three and six months ended June 30, 2013, the Company's TRSs recognized a provision for income taxes of $49.1 million and $54.1 million, respectively. The significant change in the provision for income taxes in the quarter is related to the deferred tax on unrealized gains at one of the Company's TRSs. During the three and six months ended June 30, 2012, the Company's TRSs recognized a benefit from income taxes of $16.6 million and $24.2 million, respectively.

Based on the Company's evaluation, it has been concluded that there are no significant uncertain tax positions requiring recognition in the Company's financial statements of a contingent tax liability for uncertain tax positions.

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Note 22. Earnings Per Share
The following table presents a reconciliation of the earnings and shares used in calculating basic and diluted earnings per share, or EPS, for the three and six months ended June 30, 2013 and 2012:

	Three Months Ended June 30,		Six Months Ended June 30,	
(in thousands, except share data)	2013	2012	2013	2012
Numerator:				
Net income from continuing operations	$387,621	$24,185	$529,960	$76,031
Income (loss) from discontinued operations	1,016	(181)	2,393	(227)
Net income attributable to common stockholders	$388,637	$24,004	$532,353	$75,804
Denominator:				
Weighted average common shares outstanding	365,199,790	214,764,586	335,395,275	200,784,364
Weighted average restricted stock shares	389,510	45,993	208,422	48,720
Basic weighted average shares outstanding	365,589,300	214,810,579	335,603,697	200,833,084
Dilutive weighted average warrants	467,903	—	1,073,347	—
Diluted weighted average shares outstanding	366,057,203	214,810,579	336,677,044	200,833,084
Basic Earnings Per Share:				
Continuing operations	$1.06	$0.11	$1.58	$0.38
Discontinued operations	—	—	0.01	—
Net income	$1.06	$0.11	$1.59	$0.38
Diluted Earnings Per Share:				
Continuing operations	$1.06	$0.11	$1.57	$0.38
Discontinued operations	—	—	0.01	—
Net income	$1.06	$0.11	$1.58	$0.38

During the three and six months ended June 30, 2013, the weighted average market value per share of the Company's common stock was above the exercise price of the warrants, making the warrants dilutive. For the three and six months ended June 30, 2012, the Company assumed that no warrants would be exercised as the weighted average market value per share of the Company's common stock was below the exercise price of the warrants and the warrants would be anti-dilutive.

Note 23. Related Party Transactions
The following summary provides disclosure of the material transactions with affiliates of the Company.
In accordance with the Management Agreement with PRCM Advisers, the Company incurred $12.6 million and $21.7 million as a management fee to PRCM Advisers for the three and six months ended June 30, 2013, respectively, which represents approximately 1.5% of stockholders' equity on an annualized basis as defined by the Management Agreement. However, these fees were reduced by $40,000 and $4.3 million, respectively, on the condensed consolidated statements of comprehensive (loss) income for the three and six months ended June 30, 2013 in accordance with the contribution transaction entered into with Silver Bay. See further discussion of this adjustment below. In addition, the Company reimbursed PRCM Advisers for direct and allocated costs incurred by PRCM Advisers on behalf of the Company. These direct and allocated costs totaled approximately $2.5 million and $4.5 million for the three and six months ended June 30, 2013, respectively.
In April 2012, the Company established an accounts payable function and direct relationships with the majority of its third party vendors. The Company will continue to have certain costs allocated to it by PRCM Advisers for compensation, data services and proprietary technology, but most direct expenses with third party vendors are paid directly by the Company.

The Company recognized $975,331 and $998,768 of compensation expense during the three and six months ended June 30, 2013, respectively, related to restricted stock. See Note 19 - Equity Incentive Plan for additional information.
On February 3, 2012, a subsidiary of the Company entered into an acquisition services agreement, a property management agreement and a side letter agreement regarding certain fees with Silver Bay Property Management LLC, which is a joint venture between Provident Real Estate Advisors LLC and an affiliate of PRCM Advisers and Pine River. Under the acquisition services agreement, Silver Bay Property Management assisted the Company's subsidiaries in identifying and acquiring a

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portfolio of residential real properties in various geographic areas throughout the U.S. Under the property management agreement, Silver Bay Property Management operated, maintained, repaired, managed and leased the residential properties and collected rental income for the benefit of the Company and its subsidiaries. Pursuant to the side letter, the Company's subsidiary was obligated to pay Silver Bay Property Management for various services provided under the acquisition services and property management agreements. For the three and six months ended June 30, 2012, the Company incurred $1.0 million in acquisition fees to Silver Bay Property Management which were capitalized as part of the property acquisition cost. In addition, for the three and six months ended June 30, 2012, the Company incurred $43,114 in property management fees related to Silver Bay Property Management, of which $6,114 were expensed in the condensed consolidated statements of comprehensive (loss) income. The remaining $37,000 were deferred on the condensed consolidated balance sheet as of June 30, 2012 and amortized over the lease period. These agreements were terminated on December 19, 2012 in connection with the contribution of the Company's single family rental property business to Silver Bay Realty Trust Corp., as described below.
On December 19, 2012, the Company completed the contribution of its portfolio of single family rental properties to Silver Bay Realty Trust Corp., a newly organized Maryland corporation intended to qualify as a REIT and focused on the acquisition, renovation, leasing and management of single-family residential properties for rental income and long-term capital appreciation. The Company contributed its equity interests in its wholly owned subsidiary, Two Harbors Property Investment LLC to Silver Bay Realty Trust Corp., and in exchange for its contribution, received shares of common stock of Silver Bay Realty Trust Corp. Silver Bay Realty Trust Corp. completed its initial public offering, or IPO, of its common stock on December 19, 2012. See Note 4 - Discontinued Operations for additional information. In connection with the closing of the contribution, the acquisition services agreement, property management agreement and side letter agreement referenced above were each terminated, except for certain designated provisions (e.g., protection of confidential information and indemnification), which the parties agreed would survive the termination. Not included in the gain that was recorded on the contribution in 2012 are certain adjustments to be recognized in 2013. These include an installment sales gain of approximately $4.0 million from Silver Bay Realty Trust Corp., a reduction of 2013 management fees payable to PRCM Advisers of $4.3 million, and an immaterial amount of additional working capital adjustments determined in accordance with the contribution agreement entered into with Silver Bay Realty Trust Corp. Of these amounts, $1.0 million and $2.3 million of the installment sales gain was recorded in gain on contribution of entity within discontinued operations for the three and six months ended June 30, 2013, and the full $4.3 million of the reduction of 2013 management fees payable to PRCM Advisers was recorded within management fees, on the condensed consolidated statements of comprehensive (loss) income for the six months ended June 30, 2013, respectively.

Note 24. Subsequent Events
Events subsequent to June 30, 2013, were evaluated through the date these financial statements were issued and no additional events were identified requiring further disclosure in these Condensed Consolidated Financial Statements.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations
The following discussion and analysis should be read in conjunction with the condensed consolidated financial statements and accompanying notes included elsewhere in this Quarterly Report on Form 10-Q as well as our Annual Report on Form 10-K for the year ended December 31, 2012.

General
We are a Maryland corporation focused on investing in, financing and managing residential mortgage-backed securities, or RMBS, residential mortgage loans, and other financial assets, which we collectively refer to as our target assets. We operate as a real estate investment trust, or REIT, as defined under the Internal Revenue Code of 1986, as amended, or the Code.
We are externally managed and advised by PRCM Advisers LLC, a wholly-owned subsidiary of Pine River Capital Management L.P., or Pine River, a global multi-strategy asset management firm providing comprehensive portfolio management, transparency and liquidity to institutional and high net worth investors.
Our objective is to provide attractive risk-adjusted returns to our stockholders over the long term, primarily through dividends and secondarily through capital appreciation. We selectively acquire and manage an investment portfolio of our target assets, which is constructed to generate attractive returns through market cycles. We focus on security selection and implement a relative value investment approach across various sectors within the residential mortgage market. Our target assets include the following:

- Agency RMBS (which includes inverse interest-only Agency securities classified as Agency Derivatives for purposes of U.S. GAAP), meaning RMBS whose principal and interest payments are guaranteed by the Government National Mortgage Association (or Ginnie Mae), the Federal National Mortgage Association (or Fannie Mae), or the Federal Home Loan Mortgage Corporation (or Freddie Mac);
- Non-Agency RMBS, meaning RMBS that are not issued or guaranteed by Ginnie Mae, Fannie Mae or Freddie Mac;
- Prime nonconforming residential mortgage loans, credit sensitive mortgage loans and mortgage servicing rights; and
- Other financial assets comprising approximately 5% to 10% of the portfolio.

We believe our hybrid Agency and non-Agency RMBS investment model allows management to focus on security selection and implement a relative value investment approach across various sectors within the residential mortgage market, which factors in the opportunities in the marketplace, cost of financing and cost of hedging interest rate, prepayment, credit and other portfolio risks. As a result, RMBS asset allocation reflects management's opportunistic approach to investing in the marketplace.
During the three months ended June 30, 2013, we did not significantly modify our RMBS asset allocation between Agency and non-Agency RMBS. The following table provides the RMBS asset allocation between Agency and non-Agency RMBS as of June 30, 2013 and the four immediately preceding period ends:

	As of June 30, 2013	March 31, 2013	December 31, 2012	September 30, 2012	June 30, 2012
Agency RMBS	80.5 %	80.2 %	81.0 %	83.7 %	81.7 %
Non-Agency RMBS	19.5 %	19.8 %	19.0 %	16.3 %	18.3 %

As our RMBS asset allocation shifts, our annualized yields and cost of financing shifts. As previously discussed, our investment decisions are not driven solely by annualized yields, but rather a multitude of macroeconomic drivers, including market environments and their respective impacts; for example, uncertainty of prepayment speeds, extension risk and credit events.

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For the three months ended June 30, 2013, our net interest spread realized on Agency and non-Agency RMBS was lower than prior periods. Based on recent experience, yields and net interest spreads on Agency and non-Agency RMBS securities are generally lower than what we have historically realized in our portfolio. The decrease in yields and net interest spreads across comparative periods is due primarily to the deployment of new capital in both Agency and non-Agency RMBS with lower loss adjusted yields and tighter spreads. The following table provides the average annualized yield on our Agency and non-Agency RMBS for the three months ended June 30, 2013, and the four immediately preceding quarters:

	Three Months Ended				
	June 30, 2013	March 31, 2013	December 31, 2012	September 30, 2012	June 30, 2012
Average annualized yields (1)					
Agency RMBS	2.7 %	2.9 %	2.9 %	3.1 %	3.3 %
Non-Agency RMBS	9.1 %	9.2 %	9.5 %	9.6 %	9.6 %
Aggregate RMBS	3.7 %	4.0 %	4.0 %	4.2 %	4.6 %
Cost of financing (2)	1.2 %	1.1 %	1.1 %	1.1 %	1.0 %
Net interest spread	2.5 %	2.9 %	2.9 %	3.1 %	3.6 %

(1) Average annualized yield incorporates future prepayment, credit loss and other assumptions, all of which are estimates and subject to change.
(2) Cost of financing includes swap interest rate spread.

The following table provides the average annualized yield expected on our Agency and non-Agency RMBS as of June 30, 2013, and the four immediately preceding period ends:

	As of				
	June 30, 2013	March 31, 2013	December 31, 2012	September 30, 2012	June 30, 2012
Average annualized yields (1)					
Agency RMBS	2.8 %	2.9 %	2.9 %	2.8 %	3.3 %
Non-Agency RMBS	9.1 %	9.2 %	9.4 %	9.6 %	9.6 %
Aggregate RMBS	3.8 %	3.8 %	4.0 %	3.8 %	4.5 %
Cost of financing (2)	1.2 %	1.1 %	1.2 %	1.1 %	1.0 %
Net interest spread	2.6 %	2.7 %	2.8 %	2.7 %	3.5 %

(1) Average annualized yield incorporates future prepayment, credit loss and other assumptions, all of which are estimates and subject to change.
(2) Cost of financing includes swap interest rate spread.

We seek to deploy moderate leverage as part of our investment strategy. We generally finance our RMBS assets through short-term borrowings structured as repurchase agreements. Our Agency RMBS, given their liquidity and high credit quality, are eligible for higher levels of leverage, while non-Agency RMBS, with less liquidity and exposure to credit risk, utilize lower levels of leverage. We also finance our U.S. Treasuries, which we hold for trading purposes, and our mortgage loans. We believe the debt-to-equity ratio funding our Agency RMBS, non-Agency and mortgage loans held-for-sale is the most meaningful leverage measure as U.S. Treasuries are viewed to be highly liquid in nature and collateralized borrowings on mortgage loans held-for-investment in securitization trust represents term financing with no stated maturity. As a result, our debt-to-equity ratio is determined by our RMBS portfolio mix as well as many additional factors, including the liquidity of our portfolio, the sustainability and price of our financing, diversification of our counterparties and their available capacity to finance our RMBS assets, and anticipated regulatory developments. Over the past several quarterly periods, we have generally maintained a debt-to-equity ratio range of 3.0 to 5.0 times to finance our RMBS portfolio and mortgage loans held-for-sale, on a fully deployed capital basis. Our debt-to-equity ratio is directly correlated to the make-up of our RMBS portfolio; specifically, the higher percentage of Agency RMBS we hold, the higher our debt-to-equity ratio is, and vice versa. We may alter the percentage allocation of our portfolio between Agency and non-Agency RMBS depending on the quality of the assets that are available to purchase from time to time, including at times when we are deploying proceeds from common stock offerings we conduct. The debt-to-equity ratio range has been driven by our relatively stable asset allocation between Agency and non-

Agency RMBS, as disclosed above. See the section titled "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Financial Condition -- Repurchase Agreements" for further discussion.

We recognize that investing in our target assets is competitive and that we compete with other investment vehicles for attractive investment opportunities. We rely on our management team and Pine River, who have developed strong relationships with a diverse group of financial intermediaries, to identify investment opportunities. In addition, we have benefited and expect to continue to benefit from Pine River's analytical and portfolio management expertise and infrastructure. We believe that our significant focus on the RMBS area, the extensive RMBS expertise of our investment team, our strong analytics and our disciplined relative value investment approach give us a competitive advantage versus our peers.

We have elected to be treated as a REIT for U.S. federal income tax purposes. To qualify as a REIT we are required to meet certain investment and operating tests and annual distribution requirements. We generally will not be subject to U.S. federal income taxes on our taxable income to the extent that we annually distribute all of our net taxable income to stockholders, do not participate in prohibited transactions and maintain our intended qualification as a REIT. However, certain activities that we may perform may cause us to earn income which will not be qualifying income for REIT purposes. We have designated certain of our subsidiaries as taxable REIT subsidiaries, or TRSs, as defined in the Code, to engage in such activities, and we may form additional TRSs in the future. We also 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, or the 1940 Act.

On December 19, 2012, we completed the contribution of our portfolio of single-family rental properties to Silver Bay Realty Trust Corp., or Silver Bay, a newly organized Maryland corporation intended to qualify as a REIT and focused on the acquisition, renovation, leasing and management of single family residential properties for rental income and long-term capital appreciation. We contributed our equity interests in the wholly owned subsidiary, Two Harbors Property Investment LLC, to Silver Bay, and in exchange for the contribution, received shares of common stock of Silver Bay. Silver Bay completed its initial public offering, or IPO, of its common stock on December 19, 2012. As we will not have any significant continuing involvement in Two Harbors Property Investment LLC, all of the associated operating results were removed from continuing operations and are presented separately as discontinued operations for the three and six months ended June 30, 2013 and 2012.

Forward-Looking Statements

This Quarterly Report on Form 10-Q contains, or incorporates by reference, not only historical information, but also forward-looking statements within the meaning of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, as amended. Forward-looking statements involve numerous risks and uncertainties. Our actual results may differ from our beliefs, expectations, estimates, and projections and, consequently, you should not rely on these forward-looking statements as predictions of future events. Forward-looking statements are not historical in nature and can be identified by words such as “anticipate,” “estimate,” “will,” “should,” “expect,” “target,” “believe,” “intend,” “plan” and similar expressions or their negative forms, or by references to strategy, plans, or intentions. These forward-looking statements are subject to risks and uncertainties, including, among other things, those described in our Annual Report on Form 10-K for the year ended December 31, 2012, under the caption “Risk Factors.” Other risks, uncertainties and factors that could cause actual results to differ materially from those projected are described below and may be described from time to time in reports we file with the SEC, including our Quarterly Reports on Form 10-Q and Current Reports on Form 8-K. Forward-looking statements speak only as of the date they are made, and we undertake no obligation to update or revise any such forward-looking statements, whether as a result of new information, future events, or otherwise.

Important factors, among others, that may affect our actual results include:

- changes in interest rates and the market value of our target assets;
- changes in prepayment rates of mortgage loans comprising and underlying our target assets;
- the timing of credit losses within our portfolio;

- our exposure to adjustable-rate and negative amortization mortgage loans comprising and underlying our target assets;
- the state of the credit markets and other general economic conditions, particularly as they affect the price of earning assets and the credit status of borrowers;
- the concentration of the credit risks we are exposed to;
- legislative and regulatory actions affecting the mortgage and derivative industries or our business;
- the availability of target assets for purchase at attractive prices;
- the availability of financing for our target assets, including the availability of repurchase agreement financing;
- declines in home prices;
- increases in payment delinquencies and defaults on the mortgages comprising and underlying our target assets;

- changes in liquidity in the market for real estate securities, the re-pricing of credit risk in the capital markets, inaccurate ratings of securities by rating agencies, rating agency downgrades of securities, and increases in the supply of real estate securities available-for-sale;
- changes in the values of securities we own and the impact of adjustments reflecting those changes on our statements of comprehensive (loss) income and balance sheets, including our stockholders' equity;
- our ability to generate the amount of cash flow we expect from our target assets;
- changes in our investment, financing and hedging strategies and the new risks that those changes may expose us to;
- changes in the competitive landscape within our industry, including changes that may affect our ability to retain or attract personnel;
- our ability to build and maintain successful relationships with mortgage loan originators;
- our ability to acquire mortgage loans in connection with our securitization plans;
- our ability to securitize the mortgage loans that we acquire;
- our ability to successfully diversify our business into new asset classes and manage the new risks they may expose us to;
- our ability to manage various operational risks associated with our business;
- our ability to maintain appropriate internal controls over financial reporting;
- our ability to establish, adjust and maintain appropriate hedges for the risks in our portfolio;
- our ability to maintain our REIT qualification for U.S. federal income tax purposes; and
- limitations imposed on our business due to our REIT status and our status as exempt from registration under the 1940 Act.

This Quarterly Report on Form 10-Q may contain statistics and other data that in some cases have been obtained or compiled from information made available by mortgage loan servicers and other third-party service providers.

Factors Affecting our Operating Results

Our net interest income includes income from our RMBS portfolio, including the amortization of purchase premiums and accretion of purchase discounts, and income from our residential mortgage loans. Net interest income will fluctuate primarily as a result of changes in market interest rates, our financing costs, and prepayment speeds on our assets. Interest rates, financing costs and prepayment rates 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. Our operating results will also be affected by default rates and credit losses with respect to the mortgage loans underlying our non-Agency RMBS and in our mortgage loan portfolio.

Fair Value Measurement

ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between willing market participants at the measurement date. It also establishes three levels of input to be used when measuring fair value:

Level 1	Inputs are quoted prices in active markets for identical assets or liabilities as of the measurement date under current market conditions. Additionally, the entity must have the ability to access the active market and the quoted prices cannot be adjusted by the entity.
Level 2	Inputs include quoted prices in active markets for similar assets or liabilities; quoted prices in inactive markets for identical or similar assets or liabilities; or inputs that are observable or can be corroborated by observable market data by correlation or other means for substantially the full-term of the assets or liabilities.
Level 3	Unobservable inputs are supported by little or no market activity. The unobservable inputs represent the assumptions that market participants would use to price the assets and liabilities, including risk. Generally, Level 3 assets and liabilities are valued using pricing models, discounted cash flow methodologies, or similar techniques that require significant judgment or estimation.

We follow the fair value hierarchy set forth above in order to prioritize the data utilized to measure fair value. We strive to obtain quoted market prices in active markets (Level 1 inputs). If Level 1 inputs are not available, we will attempt to obtain Level 2 inputs, observable market prices in inactive markets or derive the fair value measurement using observable market prices for similar assets or liabilities. When neither Level 1 nor Level 2 inputs are available, we use Level 3 inputs and independent pricing service models to estimate fair value measurements. At June 30, 2013, approximately 91.4% of total assets, or $18.0 billion, and approximately 2.6% of total liabilities, or $409.0 million, consisted of financial instruments recorded at fair value. As of June 30, 2013, we had $439.6 million, or 2.2%, of total assets reported at fair value using Level 3 inputs. See Note 15 - Fair Value to the Condensed Consolidated Financial Statements, included in this Quarterly Report on Form 10-Q, for descriptions of valuation methodologies used to measure material assets and liabilities at fair value and details of the valuation models, key inputs to those models and significant assumptions utilized.

A significant portion of our assets and liabilities are at fair value and, therefore, our condensed consolidated balance sheets and statements of comprehensive (loss) income are significantly affected by fluctuations in market prices. Although we execute various hedging strategies to mitigate our exposure to changes in fair value, we cannot fully eliminate our exposure to volatility caused by fluctuations in market prices. Starting in 2007, markets for asset-backed securities, including RMBS, have experienced severe dislocations. While these market disruptions continue, our assets and liabilities will be subject to valuation adjustment as well as changes in the inputs we use to measure fair value.

For the three and six months ended June 30, 2013, our unrealized fair value gains on interest rate swap and swaption agreements, which are accounted for as derivative trading instruments under GAAP, positively affected our financial results. The change in fair value of the interest rate swaps was a result of the realization of losses on interest rates swaps unwound and subsequent resetting of interest rate swaps at more favorable rates during the three months ended March 31, 2013, combined with changes to LIBOR, the swap curve and corresponding counterparty borrowing rates during the three months ended June 30, 2013. Our financial results for the three and six months ended June 30, 2013 were negatively affected by unrealized fair value losses on certain U.S. Treasuries classified as trading instruments due to their short-term investment objectives and mortgage loans held-for-sale. For the three and six months ended June 30, 2012, our unrealized fair value losses on interest rate swap and swaption agreements, which are accounted for as derivative trading instruments under GAAP, negatively affected our financial results. The change in fair value of the interest rate swaps was a result of changes to LIBOR, the swap curve, and corresponding counterparty borrowing rates during the three and six months ended June 30, 2012. Our financial results for the three and six months ended June 30, 2012 were negatively affected by unrealized fair value losses on certain U.S. Treasuries classified as trading instruments. In addition, our financial results for the three and six months ended June 30, 2013 and 2012 were affected by the unrealized gains and losses of certain other derivative instruments that were accounted for as trading derivative instruments, i.e., credit default swaps, TBAs, inverse interest-only securities and forward mortgage loan purchase commitments. Any temporary change in the fair value of our available-for-sale securities is recorded as a component of accumulated other comprehensive income and does not impact our earnings.

We have numerous internal controls in place to help ensure the appropriateness of fair value measurements. Significant fair value measures are subject to detailed analytics and management review and approval. Our entire investment portfolio is priced by third-party brokers and/or by independent pricing providers. We strive to obtain multiple market data points for each valuation. We utilize “bid side” pricing for our RMBS assets and, as a result, certain assets, especially the most recent purchases, may realize a markdown due to the “bid-offer” spread. To the extent that this occurs, any economic effect of this would be reflected in accumulated other comprehensive income. We back test the fair value measurements provided by the pricing providers against actual performance. We also monitor the market for recent trades, market surveys, or other market information that may be used to benchmark pricing provider inputs.

Considerable judgment is used in forming conclusions and estimating inputs to our Level 3 fair value measurements. Level 3 inputs such as interest rate movements, prepayments speeds, credit losses and discount rates are inherently difficult to estimate. Changes to these inputs can have a significant effect on fair value measurements. Accordingly, there is no assurance that our estimates of fair value are indicative of the amounts that would be realized on the ultimate sale or exchange of these assets.

Market Conditions and Outlook

The key macroeconomic factors that impact our business are home prices, interest rates and employment. Home price performance is important to our non-Agency portfolio. We are continuing to see signs of stabilization and improvements in housing prices. Forecasts call for a continuation of home price appreciation over the next several years, albeit at a slower pace than 2012. Despite the improvement in housing prices, loan-to-value ratios remain high and have the effect of limiting a borrower's ability to refinance despite low interest rates and government policy programs that promote refinancing. The low interest rate environment is expected to persist, absent a substantial improvement in economic conditions and employment, influencing funding costs and prepayment speeds. A low Federal Funds Target Rate is expected to benefit funding costs for the next few years. Employment trends have begun to improve; however, current unemployment levels remain stubbornly high. Next to loan-to-value ratios, employment is the most powerful determinant of a homeowner's ongoing likelihood to pay their mortgage.

The first six months of 2013 continued to produce a number of regulatory actions in an effort to stabilize economic conditions and increase liquidity in the financial markets as well as other actions related to the fall-out from the financial and foreclosure crises. Regulatory actions that could affect the value of our RMBS, either positively or negatively, include attempts by the U.S. government to further streamline the refinancing process to allow more borrowers to refinance into lower interest rate mortgage loans; the Federal Housing Finance Agency's announcement that the GSEs will implement a new, streamlined loan modification initiative for borrowers that are 90+ days delinquent; the possibility of an REO-to-rental program supported by the GSEs; an expansion of the HAMP refinancing program to include borrowers whose loans are not in GSE pools; and the Federal Reserve's so-called "Operation Twist." Although interest rates remain low in a historic context, they rose in the second quarter, due in part to improving employment statistics and other economic indicators. Additionally, based on the strength of economic data, the Federal Reserve suggested a potential tapering of RMBS purchases which impacted the market. Separately, the U.S. economy continues to be burdened by the ongoing European debt crisis, elevated unemployment numbers and a struggling housing market, which, despite signs of an approaching recovery, remains weighted with backlogs of homes in the foreclosure process. Meanwhile, mortgage servicers continue to evaluate the impacts of the recent settlement with State Attorneys General over improper servicing and foreclosure practices and the adoption by several states of various legislation aimed at curtailing or modifying foreclosure processes. Events such as these will continue to affect our portfolio.

We believe our blended Agency and non-Agency strategies and our investing expertise will allow us to better navigate the dynamic characteristics of the RMBS environment while GSE reform and any other future regulatory efforts take shape. Having a diversified portfolio allows us to mitigate risks, including the volatility and impacts generated by uncertainty in interest rates and changes in prepayments, home prices and homeowner default rates. As such, we are exploring new opportunities that capitalize on our prepayment and credit expertise, including prime nonconforming residential mortgage loans, credit sensitive loans and mortgage servicing rights.

We expect that the majority of our assets will remain in whole-pool Agency RMBS in light of the long-term attractiveness of the asset class and in order to continue to satisfy the requirements of our exemption from registration under the 1940 Act. Interest-only Agency securities also provide a complementary investment and risk-management strategy to our principal and interest Agency RMBS investments. Risk-adjusted returns in our Agency RMBS portfolio may decline if we are required to pay higher purchase premiums due to lower interest rates or additional liquidity in the market. Additionally, the Federal Reserve's open-ended program to purchase RMBS may impact the returns of our Agency RMBS portfolio.

The following table provides the carrying value of our RMBS portfolio by product type:

(dollars in thousands)	June 30, 2013			December 31, 2012		
Agency						
Fixed Rate	$11,770,146	77.8	%	$10,823,674	77.5	%
Hybrid ARMs	170,682	1.1	%	188,429	1.3	%
Total Agency	11,940,828	78.9	%	11,012,103	78.8	%
Agency Derivatives	241,848	1.6	%	301,264	2.2	%
Non-Agency						
Senior	2,443,731	16.1	%	2,132,272	15.3	%
Mezzanine	498,963	3.3	%	518,466	3.7	%
Interest-only securities	8,793	0.1	%	4,113	—	%
Total Non-Agency	2,951,487	19.5	%	2,654,851	19.0	%
Total	$15,134,163			$13,968,218		

Prepayment speeds and volatility due to interest rates

Our Agency RMBS portfolio is subject to inherent prepayment risk: generally, a decline in interest rates that leads to rising prepayment speeds will cause the market value of our interest-only securities to deteriorate, but will cause the market value of our fixed coupon Agency pools to increase. The inverse relationship occurs when interest rates increase and prepayments slow. Housing prices have increased over the past year, but are still generally much lower than at the peak of the housing market. This, combined with elevated unemployment rates and housing inventory, leads us to expect that there will not be a significant increase in prepayment speeds in 2013. However, given the low level of interest rates, the extension of HARP 2.0 to the end of 2015, and the revamped Home Affordable Refinance Program, prepayment speeds, particularly due to refinancings, have increased on many RMBS. These government actions, combined with other potential government programs, could also lead to a further increase in prepayment speeds in RMBS, which could lead to less attractive reinvestment opportunities. Nonetheless, we believe our portfolio approach, including our security selection process, is well positioned to respond to a variety of market scenarios, including an overall faster prepayment environment.

Although we are unable to predict the movement in interest rates in 2013 and beyond, our blended Agency and non-Agency portfolio strategy is intended to generate attractive yields with a low level of sensitivity to yield curve, prepayments and interest rate cycles.

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Our portfolio includes Agency securities, which includes bonds with explicit prepayment protection, $85K maximum loan balance pools (securities collateralized by loans of less than $85,000 in principal), other low loan balances (securities collateralized by loans of less than $175,000, but more than $85,000 in principal), high loan-to-value (or LTV) ratios (securities collateralized by loans with greater or equal to 80% LTV predominantly comprised of Making Homeownership Affordable (or MHA) pools that consist of borrowers who have refinanced through HARP), home equity conversion mortgages (securities collateralized by reverse mortgages), low FICO scores (lower credit borrowers), and seasoned bonds reflecting less prepayment risk due to previously experienced high levels of refinancing. We believe these RMBS characteristics reduce the prepayment risk to the portfolio.
The following tables provide the carrying value of our Agency RMBS portfolio by vintage and prepayment protection:

	As of June 30, 2013					
	Agency RMBS AFS		Agency	Total Agency RMBS		
(dollars in thousands)	Fixed Rate	Hybrid ARMs	Derivatives			
High LTV (predominantly MHA)	$3,112,951	$—	$—	$3,112,951	26	%
$85K Max Pools	2,457,037	—	—	2,457,037	20	%
Home equity conversion mortgages	1,836,735	—	—	1,836,735	15	%
Other low loan balances	1,706,882	—	—	1,706,882	14	%
2006 and subsequent vintages	900,280	38,556	—	938,836	8	%
Low FICO	739,034	—	—	739,034	6	%
Seasoned (2005 and prior vintages)	304,809	119,736	166,475	591,020	5	%
Pre-pay lock-out or penalty-based	499,220	12,390	—	511,610	4	%
2006 and subsequent vintages - discount	213,198	—	75,373	288,571	2	%
Total	$11,770,146	$170,682	$241,848	$12,182,676	100	%

	As of December 31, 2012					
	Agency RMBS AFS		Agency	Total Agency RMBS		
(dollars in thousands)	Fixed Rate	Hybrid ARMs	Derivatives			
High LTV (predominantly MHA)	$2,904,683	$—	$—	$2,904,683	27	%
$85K Max Pools	2,262,443	—	—	2,262,443	20	%
Home equity conversion mortgages	1,906,957	—	—	1,906,957	17	%
Other low loan balances	1,720,319	—	—	1,720,319	16	%
2006 and subsequent vintages	200,390	44,987	—	245,377	2	%
Low FICO	781,855	—	—	781,855	7	%
Seasoned (2005 and prior vintages)	345,412	129,940	207,869	683,221	5	%
Pre-pay lock-out or penalty-based	541,495	13,502	—	554,997	4	%
2006 and subsequent vintages - discount	160,120	—	93,395	253,515	2	%
Total	$10,823,674	$188,429	$301,264	$11,313,367	100	%

We offset a portion of the Agency exposure to prepayment speeds through our non-Agency portfolio. Our non-Agency RMBS yields are expected to increase if prepayment rates on such assets exceed our prepayment assumptions. To the extent that prepayment speeds increase due to macroeconomic factors, we expect to benefit from the ability to recognize the income from the heavily discounted RMBS prices that principally arose from credit or payment default expectations.

The following tables provide discount information on our non-Agency RMBS portfolio:

	As of June 30, 2013			
(in thousands)	Principal and Interest Securities		Interest-Only Securities	Total
	Senior	Mezzanine		
Face Value	$3,932,358	$702,444	$359,890	$4,994,692
Unamortized discount				
Designated credit reserve	(1,270,976)	(115,631)	—	(1,386,607)
Unamortized net discount	(694,622)	(176,459)	(351,537)	(1,222,618)
Amortized Cost	$1,966,760	$410,354	$8,353	$2,385,467

	As of December 31, 2012			
(in thousands)	Principal and Interest Securities		Interest-Only Securities	Total
	Senior	Mezzanine		
Face Value	$3,685,422	$753,084	$65,493	$4,503,999
Unamortized discount				
Designated credit reserve	(1,179,811)	(111,135)	—	(1,290,946)
Unamortized net discount	(718,101)	(216,459)	(61,930)	(996,490)
Amortized Cost	$1,787,510	$425,490	$3,563	$2,216,563

Credit losses

Although our Agency portfolio is supported by U.S. Government agency and federally chartered corporation guarantees of payment of principal and interest, we are exposed to credit risk in our non-Agency RMBS portfolio and mortgage loans. However, the credit support built into non-Agency RMBS deal structures is designed to provide a level of protection from potential credit losses for more senior tranches. In addition, the discounted purchase prices paid on our non-Agency RMBS and credit sensitive mortgage loans provide additional insulation from credit losses in the event we receive less than 100% of par on such assets. We evaluate credit risk on our non-Agency investments and credit sensitive mortgage loans through a comprehensive asset selection process, which is predominantly focused on quantifying and pricing credit risk. We evaluate credit risk on our non-Agency investments through a comprehensive asset selection process, which is predominantly focused on quantifying and pricing credit risk, including extensive initial modeling and scenario analysis. We review on an on-going basis our non-Agency RMBS and credit sensitive mortgage loans based on a quantitative and qualitative analysis of the risk-adjusted returns on such investments and through on-going asset surveillance. Specific to our non-Agency RMBS, at purchase, we estimate the portion of the discount we do not expect to recover and factor that into our expected yield and accretion methodology. We may also record an other-than-temporary impairment, or OTTI, for a portion of our investment in a security to the extent we believe that the amortized cost exceeds the present value of expected future cash flows. Nevertheless, unanticipated credit losses could occur, adversely impacting our operating results.

Counterparty exposure and leverage ratio

We monitor counterparty exposure in our broker, banking and lending counterparties on a daily basis. We believe our broker and banking counterparties are well capitalized organizations and we attempt to manage our cash balances across these organizations to reduce our exposure to a single counterparty.

We had entered into repurchase agreements with 24 counterparties as of June 30, 2013, 20 of which had outstanding balances at June 30, 2013. In addition, we had entered into three facilities that provide short-term financing for our mortgage loan collateral during our aggregation period, two of which had outstanding balances at June 30, 2013. As of June 30, 2013, we had a total consolidated debt to equity ratio of 4.0 times. As of June 30, 2013, we had $917.2 million in cash and cash equivalents, approximately $44.7 million of unpledged Agency securities and derivatives and $634.2 million of unpledged non-Agency securities and an overall estimated unused borrowing capacity on our unpledged RMBS of approximately $398.3 million. We also had approximately $45.0 million of unpledged prime nonconforming residential mortgage loans and $438.2 million of unpledged credit sensitive residential mortgage loans and an overall estimated unused borrowing capacity on unpledged mortgage loans held-for-sale of approximately $281.5 million. If borrowing rates and collateral requirements change in the near term, we believe we are subject to less earnings volatility than a more levered organization.

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Summary of Results of Operations and Financial Condition

Our reported GAAP net income attributable to common stockholders was $388.6 million ($1.06 per diluted weighted share) for the three months ended June 30, 2013 as compared to $24.0 million ($0.11 per diluted weighted share) for the three months ended June 30, 2012.

With our accounting treatment for AFS securities, unrealized fluctuations in the market values of securities do not impact our GAAP or taxable income but are recognized on our balance sheet as a change in stockholder's equity under “accumulated other comprehensive income.” As a result of this fair value accounting through stockholder's equity, we expect our net income to have less significant fluctuations and result in less GAAP to taxable income timing differences, than if the portfolio were accounted as trading instruments. For the three months ended June 30, 2013 and 2012, net unrealized losses on available-for-sale securities recognized as other comprehensive loss were $534.7 million and net unrealized gains on available-for-sale securities recognized as other comprehensive income were $117.6 million, respectively, which resulted in comprehensive loss of $146.1 million for the three months ended June 30, 2013 as compared to comprehensive income of $141.6 million for the three months ended June 30, 2012.

On June 18, 2013, we declared a cash dividend of $0.31 per diluted share. Our GAAP book value per diluted common share was $10.47 at June 30, 2013, a decrease from $11.54 book value per diluted common share at December 31, 2012.

The following tables present the components of our comprehensive (loss) income for the three and six months ended June 30, 2013 and 2012:

(in thousands, except share data)	Three Months Ended		Six Months Ended	
Income Statement Data:	June 30,		June 30,	
	2013	2012	2013	2012
Interest income:	(unaudited)		(unaudited)	
Available-for-sale securities	$134,651	$104,319	$264,943	$188,533
Trading securities	1,261	1,250	2,525	2,300
Mortgage loans held-for-sale	4,794	126	6,112	195
Mortgage loans held-for-investment in securitization trust	4,369	—	6,023	—
Cash and cash equivalents	250	209	557	377
Total interest income	145,325	105,904	280,160	191,405
Interest expense:				
Repurchase agreements	22,553	15,527	45,571	26,994
Collateralized borrowings in securitization trust	2,169	—	2,987	—
Total interest expense	24,722	15,527	48,558	26,994
Net interest income	120,603	90,377	231,602	164,411
Other-than-temporary impairment losses	(1,426)	(4,476)	(1,662)	(8,751)
Other income:				
Gain on investment securities	50,863	1,789	77,831	11,720
Gain (loss) on interest rate swap and swaption agreements	259,826	(61,014)	278,798	(77,207)
Gain (loss) on other derivative instruments	62,283	(7,577)	45,621	(16,480)
(Loss) gain on mortgage loans held-for-sale	(35,142)	10	(20,819)	(22)
Other income	1,810	—	8,099	—
Total other income (loss)	339,640	(66,792)	389,530	(81,989)
Expenses:				
Management fees	12,591	7,610	17,352	14,353
Securitization deal costs	—	—	2,028	—
Other operating expenses	9,486	3,919	16,047	7,470
Total expenses	22,077	11,529	35,427	21,823
Income from continuing operations before income taxes	436,740	7,580	584,043	51,848
Provision for (benefit from) income taxes	49,119	(16,605)	54,083	(24,183)
Net income from continuing operations	387,621	24,185	529,960	76,031
Income (loss) from discontinued operations	1,016	(181)	2,393	(227)
Net income attributable to common stockholders	$388,637	$24,004	$532,353	$75,804
Basic earnings per weighted average common share:				
Continuing operations	$1.06	$0.11	$1.58	$0.38
Discontinued operations	—	—	0.01	—
Net income	$1.06	$0.11	$1.59	$0.38
Diluted earnings per weighted average common share:				
Continuing operations	$1.06	$0.11	$1.57	$0.38
Discontinued operations	—	—	0.01	—
Net income	$1.06	$0.11	$1.58	$0.38
Dividends declared per common share	$0.31	$0.40	$0.63	$0.80
Weighted average number of shares of common stock:				

Basic	365,589,300	214,810,579	335,603,697	200,833,084
Diluted	366,057,203	214,810,579	336,677,044	200,833,084

(in thousands) Income Statement Data:	Three Months Ended June 30, 2013 (unaudited)	2012	Six Months Ended June 30, 2013 (unaudited)	2012
Comprehensive (loss) income:				
Net income	$388,637	$24,004	$532,353	$75,804
Other comprehensive (loss) income:				
Unrealized (loss) gain on available-for-sale securities, net	(534,713)	117,604	(430,461)	261,514
Other comprehensive (loss) income	(534,713)	117,604	(430,461)	261,514
Comprehensive (loss) income	$(146,076)	$141,608	$101,892	$337,318

(in thousands) Balance Sheet Data:	June 30, 2013 (unaudited)	December 31, 2012
Available-for-sale securities	$14,892,315	$13,666,954
Total assets	$19,640,751	$16,813,944
Repurchase agreements	$14,903,155	$12,624,510
Total stockholders' equity	$3,834,123	$3,450,577

Results of Operations

The following analysis focuses on the results generated during the three and six months ended June 30, 2013 and 2012.

Interest Income and Average Portfolio Yield

For the three and six months ended June 30, 2013, we recognized $134.7 million and $264.9 million, respectively, of interest income from our Agency and non-Agency RMBS AFS portfolio. Our RMBS AFS portfolio's average amortized cost of securities was approximately $14.6 billion and $13.9 billion for the three and six months ended June 30, 2013, resulting in an annualized net yield of approximately 3.7% and 3.8%, respectively. For the three and six months ended June 30, 2012, we recognized $104.3 million and $188.5 million, respectively, of interest income from our Agency and non-Agency RMBS AFS portfolio. Our RMBS AFS portfolio's average amortized cost of securities was approximately $9.5 billion and $8.4 billion for the three and six months ended June 30, 2012, resulting in an annualized net yield of approximately 4.4% and 4.5%, respectively.

For the three and six months ended June 30, 2013, we recognized $46.8 million and $84.9 million, respectively, of net premium amortization on our Agency RMBS AFS, including our interest-only securities. This resulted in an overall net asset yield of approximately 2.7% and 2.8%, respectively, excluding inverse interest-only securities which are accounted for as derivatives. For the three and six months ended June 30, 2013, we recognized $37.2 million and $72.5 million of accretion income from the discounts on our non-Agency portfolio resulting in an overall net yield of approximately 9.1% for both periods. For the three and six months ended June 30, 2012, we recognized $31.0 million and $54.0 million, respectively, of net premium amortization on our Agency RMBS AFS, including our interest-only securities. This resulted in an overall net asset yield of approximately 3.0% and 3.1%, respectively, excluding inverse interest-only securities which are accounted for as derivatives. For the three and six months ended June 30, 2012, we recognized $34.1 million and $63.0 million of accretion income from the discounts on our non-Agency portfolio resulting in an overall net yield of approximately 9.6% and 9.7%, respectively. The decrease in gross and net yields across comparative periods is due primarily to the deployment of new capital in both Agency and non-Agency RMBS AFS with lower loss adjusted yields.

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The following tables present the components of the net yield earned by investment type on our RMBS AFS portfolio as a percentage of our average amortized cost of securities (ratios for the periods have been annualized):

	Three Months Ended June 30, 2013			Six Months Ended June 30, 2013		
	Agency	Non-Agency	Consolidated	Agency	Non-Agency	Consolidated
Gross Yield/Stated Coupon	4.2 %	2.7 %	4.0 %	4.2 %	2.8 %	4.0 %
Net (Premium Amortization)/Discount Accretion	(1.5)%	6.4 %	(0.3)%	(1.4)%	6.3 %	(0.2)%
Net Yield [(1)]	2.7 %	9.1 %	3.7 %	2.8 %	9.1 %	3.8 %

	Three Months Ended June 30, 2012			Six Months Ended June 30, 2012		
	Agency	Non-Agency	Consolidated	Agency	Non-Agency	Consolidated
Gross Yield/Stated Coupon	4.7 %	2.7 %	4.3 %	4.7 %	2.8 %	4.3 %
Net (Premium Amortization)/Discount Accretion	(1.7)%	6.9 %	0.1 %	(1.6)%	6.9 %	0.2 %
Net Yield [(1)]	3.0 %	9.6 %	4.4 %	3.1 %	9.7 %	4.5 %

(1) These yields have not been adjusted for cost of delay and cost to carry purchase premiums.

The following tables provide the components of interest income and net asset yield by investment type on our RMBS AFS portfolio:

	Three Months Ended June 30, 2013			Six Months Ended June 30, 2013		
(dollars in thousands)	Agency	Non-Agency	Total	Agency	Non-Agency	Total
Average amortized cost	$12,216,046	$2,358,645	$14,574,691	$11,642,500	$2,300,230	$13,942,730
Coupon interest	128,136	16,119	144,255	245,496	31,853	277,349
Net (premium amortization)/discount accretion	(46,825)	37,221	(9,604)	(84,917)	72,511	(12,406)
Interest income	$81,311	$53,340	$134,651	$160,579	$104,364	$264,943
Net asset yield	2.7 %	9.1 %	3.7 %	2.8 %	9.1 %	3.8 %

	Three Months Ended June 30, 2012			Six Months Ended June 30, 2012		
(dollars in thousands)	Agency	Non-Agency	Total	Agency	Non-Agency	Total
Average amortized cost	$7,503,643	$1,984,559	$9,488,202	$6,522,125	$1,835,357	$8,357,482
Coupon interest	87,616	13,570	101,186	153,795	25,680	179,475
Net (premium amortization)/discount accretion	(30,988)	34,121	3,133	(53,960)	63,018	9,058
Interest income	$56,628	$47,691	$104,319	$99,835	$88,698	$188,533
Net asset yield	3.0 %	9.6 %	4.4 %	3.1 %	9.7 %	4.5 %

For the three and six months ended June 30, 2013, we recognized $1.3 million and $2.5 million of interest income, respectively, associated with our trading U.S. Treasuries, or approximately 0.5% and 0.5% annualized net yield on average amortized cost. Additionally, for the three and six months ended June 30, 2013, we recognized $4.8 million and $6.1 million of interest income, respectively, associated with our mortgage loans held-for-sale, or approximately 4.7% and 4.9% annualized net yield on average carrying value. For the three and six months ended June 30, 2013, we also recognized $4.4 million and $6.0 million of interest income associated with our mortgage loans held-for-investment in securitization trust, or approximately 4.1% and 4.1% annualized net yield on average carrying value. For the three and six months ended June 30, 2012, we recognized $1.3 million and $2.3 million of interest income, respectively, associated with our trading U.S. Treasuries, or approximately 0.5% annualized net yield on average amortized cost for both periods. Additionally, for the three and six months

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ended June 30, 2012, we recognized $0.1 million and $0.2 million of interest income, respectively, associated with our mortgage loans held-for-sale, or approximately 4.7% and 4.7% annualized net yield on average carrying value.

Interest Expense and the Cost of Funds

For the three and six months ended June 30, 2013, we recognized $21.4 million and $43.0 million, respectively, in interest expense on our borrowed funds collateralized by RMBS AFS. For the same three and six month periods, our average outstanding balance under repurchase agreements to fund RMBS AFS was approximately $13.1 billion and $12.6 billion, respectively, an increase from second quarter 2012 due to our increased capital base. The average cost of funds, excluding interest spread expense associated with interest rate swaps, for the three and six months ended June 30, 2013, was 0.7% for both periods. For the three and six months ended June 30, 2012, we recognized $14.4 million and $25.1 million, respectively, in interest expense on our borrowed funds collateralized by RMBS AFS. For the same three and six month periods, our average outstanding balance under repurchase agreements to fund RMBS AFS was approximately $8.3 billion and $7.3 billion, respectively, resulting in an average cost of funds on our RMBS AFS, excluding interest spread expense associated with interest rate swaps, of 0.7% for both periods.

For the three and six months ended June 30, 2013, we recognized $0.9 million and $2.0 million, respectively, of interest expense associated with the financing of our U.S. Treasuries and Agency inverse interest-only derivatives, or an average cost of funds of approximately 0.3% for both periods. Additionally, for the three and six months ended June 30, 2013, we recognized $0.2 million and $0.5 million, respectively, of interest expense associated with the financing of our mortgage loans held-for-sale, or an average cost of funds of approximately 2.7% and 2.6%. For the three and six months ended June 30, 2013, we also recognized $2.2 million and $3.0 million, respectively, of interest expense associated with the financing of our mortgage loans held-for-investment in securitization trust, or an average cost of funds of approximately 2.2% for both periods. The additional funds borrowed during the six months ended June 30, 2013, resulted in a total consolidated debt-to-equity ratio of 4.0:1.0. For the three and six months ended June 30, 2012, we recognized $1.1 million and $1.9 million, respectively, of interest expense associated with the financing of our U.S. Treasuries and Agency inverse interest-only derivatives, or an average cost of funds of approximately 0.4% and 0.3%. Additionally, for the three and six months ended June 30, 2012, we recognized $40,830 and $83,236, respectively, of interest expense associated with the financing of our mortgage loans held-for-sale, or an average cost of funds of approximately 3.1% and 3.2%. The additional funds borrowed during the six months ended June 30, 2012, resulted in a total consolidated debt-to-equity ratio of 4.8:1.0.

Net Interest Income

For the three and six months ended June 30, 2013, net interest income on our RMBS AFS portfolio was $113.3 million and $221.9 million, respectively, resulting in a net interest spread of approximately 3.0% and 3.1%, respectively. For the three and six months ended June 30, 2012, net interest income on our RMBS AFS portfolio was $89.9 million and $163.5 million, respectively, resulting in a net interest spread of approximately 3.7% and 3.8%, respectively. The decrease in net interest spread across comparative periods is due primarily to the deployment of new capital in both Agency and non-Agency RMBS AFS with lower loss adjusted yields and tighter spreads.

The following table provides the interest income and expense incurred in the three and six months ended June 30, 2013 and 2012:

	Three Months Ended June 30, 2013			Six Months Ended June 30, 2013		
(dollars in thousands)	Agency(1)	Non-Agency	Total	Agency(1)	Non-Agency	Total
Average available-for-sale securities held (2)	$12,216,046	$2,358,645	$14,574,691	$11,642,500	$2,300,230	$13,942,730
Total interest income	$81,311	$53,340	$134,651	$160,579	$104,364	$264,943
Yield on average investment securities	2.7 %	9.1 %	3.7 %	2.8 %	9.1 %	3.8 %
Average balance of repurchase agreements	$11,849,280	$1,254,343	$13,103,623	$11,288,756	$1,274,469	$12,563,225
Total interest expense (3) (4)	$14,037	$7,356	$21,393	$27,867	$15,171	$43,038
Average cost of funds (4)	0.5 %	2.3 %	0.7 %	0.5 %	2.4 %	0.7 %
Net interest income	$67,274	$45,984	$113,258	$132,712	$89,193	$221,905
Net interest rate spread	2.2 %	6.8 %	3.0 %	2.3 %	6.7 %	3.1 %
	Three Months Ended June 30, 2012			Six Months Ended June 30, 2012		
(dollars in thousands)	Agency(1)	Non-Agency	Total	Agency(1)	Non-Agency	Total
Average available-for-sale securities held (2)	$7,503,643	$1,984,559	$9,488,202	$6,522,125	$1,835,357	$8,357,482
Total interest income	$56,628	$47,691	$104,319	$99,835	$88,698	$188,533
Yield on average investment securities	3.0 %	9.6 %	4.4 %	3.1 %	9.7 %	4.5 %
Average balance of repurchase agreements	$7,255,312	$1,073,773	$8,329,085	$6,309,389	$978,478	$7,287,867
Total interest expense (3) (4)	$8,215	$6,189	$14,404	$13,759	$11,294	$25,053
Average cost of funds (4)	0.5 %	2.3 %	0.7 %	0.4 %	2.3 %	0.7 %
Net interest income	$48,413	$41,502	$89,915	$86,076	$77,404	$163,480
Net interest rate spread	2.5 %	7.3 %	3.7 %	2.7 %	7.4 %	3.8 %

(1) Excludes inverse interest-only securities which are classified as derivatives under U.S. GAAP. For the three and six months ended June 30, 2013, our average annualized yield on our Agency RMBS, including inverse interest-only securities, was 2.7% and 2.8%, respectively, compared to 3.3% and 3.4% for the same periods in 2012.

(2) Excludes change in realized and unrealized gains/(losses).

(3) Cost of funds by investment type is based on the underlying investment type of the RMBS AFS assigned as collateral.

(4) Cost of funds does not include the accrual and settlement of interest associated with interest rate swaps. In accordance with GAAP, those costs are included in loss on interest rate swap and swaption agreements in the condensed consolidated statements of comprehensive (loss) income. For the three and six months ended June 30,

2013, our average cost of funds, including interest spread expense associated with interest rate swaps and including inverse interest-only securities (see footnote 1 above), was 1.2% and 1.2%, respectively, compared to 1.0% and 1.0% for the same periods in 2012.

Other-Than-Temporary Impairments

We review each of our securities on a quarterly basis to determine if an OTTI charge is necessary. For the three and six months ended June 30, 2013, we recognized $1.4 million and $1.7 million of OTTI losses, respectively, compared to $4.5 million and $8.8 million for the three and six months ended June 30, 2012. The decrease in OTTI during the three and six months ended June 30, 2013, compared to the same periods in 2012, was generally driven by recovery in the non-Agency market from June 30, 2012 to June 30, 2013. For further information about evaluating AFS securities for other-than-temporary impairments, refer to Note 5 - Available-for-Sale Securities, at Fair Value of the notes to the condensed consolidated financial statements.

Gain on Investment Securities

During the three and six months ended June 30, 2013, we sold AFS securities for $189.7 million and $986.4 million with an amortized cost of $137.3 million and $915.0 million, for a net realized gain of $52.4 million and $71.4 million, respectively.

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We did not sell any U.S. Treasuries during the three and six months ended June 30, 2013. During the three and six months ended June 30, 2012, we sold AFS and trading securities for $1.0 billion and $1.2 billion with an amortized cost of $1.0 billion and $1.2 billion, for a net realized gain of $0.6 million and $11.7 million, respectively, which included sales of U.S. Treasuries with an amortized cost of $1.0 billion and $1.0 billion for the three and six months ended June 30, 2012. We do not expect to sell assets on a frequent basis, but may sell assets to reallocate capital into new assets that our management believes have higher risk-adjusted returns.

For both the three and six months ended June 30, 2013, trading securities experienced change in unrealized losses of $1.6 million. For the three and six months ended June 30, 2012, trading securities experienced change in unrealized gains of $1.2 million and unrealized losses of $10,934, respectively.

On March 18, 2013, we declared a special dividend pursuant to which the 17,824,647 shares of Silver Bay common stock would be distributed, on a pro rata basis, to our stockholders of record at the close of business on April 2, 2013. The dividend was payable on or about April 24, 2013. As a result, we recognized $13.7 million of realized gains on distribution as well as $13.7 million and $5.9 million of change in unrealized losses within gain on investment securities for the three and six months ended June 30, 2013, respectively. Also included in gain on investment securities for the six months ended June 30, 2013, is $0.2 million in dividend income from Silver Bay's $0.01 per share dividend declared on March 21, 2013.

Gain (Loss) on Interest Rate Swap and Swaption Agreements

For the three and six months ended June 30, 2013, we recognized $19.4 million and $33.4 million, respectively, of expenses for the accrual and/or settlement of the net interest expense associated with our interest rate swaps. The expenses result from generally paying a fixed interest rate on an average $17.7 billion and $16.3 billion notional, respectively, to hedge a portion of our interest rate risk on our short-term repurchase agreements, funding costs, and macro-financing risk and generally receiving LIBOR interest. For the three and six months ended June 30, 2012, we recognized $7.7 million and $12.4 million, respectively, of expenses for the accrual and/or settlement of the net interest expense associated with our interest rate swaps. The expenses result from generally paying a fixed interest rate on an average $8.2 billion and $7.3 billion notional, respectively, to hedge a portion of our interest rate risk on our short-term repurchase agreements, funding costs, and macro-financing risk and generally receiving LIBOR interest.

During the three and six months ended June 30, 2013, we terminated, had agreements mature or had options expire on three and 72 interest rate swap and swaption positions of $0.3 billion and $8.5 billion notional, respectively. Upon settlement of the early terminations and option expirations, we paid $17.2 million in full settlement of our net interest spread liability and recognized $4.0 million and $62.7 million in realized losses on the swaps and swaptions, respectively, including early termination penalties. During the three and six months ended June 30, 2012, we terminated, had agreements mature or had options expire on eight and 19 interest rate swap and swaption positions of $2.0 billion and $2.9 billion notional, respectively. Upon settlement of the early terminations and option expirations, we paid $1.0 million and $1.5 million in full settlement of our net interest spread liability and recognized $7.3 million and $18.5 million in realized losses on the swaps and swaptions, respectively, including early termination penalties. We elected to terminate certain swaps to reduce our cost of financing and align with our investment portfolio.

Also included in our financial results for the three and six months ended June 30, 2013, was the recognition of a change in unrealized valuation gains of $283.2 million and $374.9 million, respectively, on our interest rate swap and swaption agreements that were accounted for as trading instruments. For the three and six months ended June 30, 2012, we recognized changes in unrealized valuation losses of $46.1 million and $46.3 million, respectively, on our interest rate swap and swaption agreements that were accounted for as trading instruments. The change in fair value of interest rate swaps was a result of the realization of losses on interest rates swaps unwound and subsequent resetting of interest rate swaps at more favorable rates during the three months ended March 31, 2013, combined with changes to LIBOR, the swap curve and corresponding counterparty borrowing rates during the three months ended June 30, 2013. Since these swaps and swaptions are used for purposes of hedging our interest rate exposure, their unrealized valuation gains are generally offset by unrealized losses in our Agency RMBS AFS portfolio, which are recorded directly to stockholders' equity through other comprehensive (loss) income.

The following table provides the net interest spread and gains and losses associated with our interest rate swap and swaption positions:

(in thousands)	Three Months Ended June 30, 2013	Three Months Ended June 30, 2012	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
Net interest spread	$(19,395)	$(7,655)	$(33,411)	$(12,371)
Early termination and option expiration losses	(3,983)	(7,275)	(62,675)	(18,540)
Change in unrealized gain (loss) on interest rate swap and swaption agreements, at fair value	283,204	(46,084)	374,884	(46,296)
Gain (loss) on interest rate swap and swaption agreements	$259,826	$(61,014)	$278,798	$(77,207)

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Gain (Loss) on Other Derivative Instruments

Included in our financial results for the three and six months ended June 30, 2013, was the recognition of $62.3 million and $45.6 million of losses, respectively, on other derivative instruments we hold for purposes of both hedging and non-hedging activities, principally credit default swaps, TBAs and inverse interest-only securities. Included within the results for the three and six months ended June 30, 2013, we recognized $2.3 million and $6.8 million of interest income, net of accretion on inverse interest-only securities on an average amortized cost basis of $282.6 million and $277.2 million, respectively. The remainder represented realized and unrealized net gains (losses) on other derivative instruments. As these derivative instruments are considered trading instruments, our financial results include both realized and unrealized gains (losses) associated with these instruments.

Included in our financial results for the three and six months ended June 30, 2012, was the recognition of $7.6 million and $16.5 million of losses, respectively, on other derivative instruments we hold for purposes of both hedging and non-hedging activities, principally credit default swaps, TBAs and inverse interest-only securities. Included within the results for the three and six months ended June 30, 2012, we recognized $7.6 million and $14.3 million of interest income, net of accretion on inverse interest-only securities on an average amortized cost basis of $255.5 million and $220.6 million, respectively. The remainder represented realized and unrealized net gains (losses) on other derivative instruments.

(Loss) Gain on Mortgage Loans Held-for-Sale

For the three and six months ended June 30, 2013, we recorded losses on mortgage loans held-for-sale of $35.1 million and $20.8 million, respectively. Included within the results for the three and six months ended June 30, 2013, we recognized $14.8 million and $0.8 million of losses on mortgage loans held-for-sale and $20.3 million and $20.0 million of losses on commitments to purchase mortgage loans held-for-sale, respectively.

For the three and six months ended June 30, 2012, we recorded a gain on mortgage loans held-for-sale of $9,465 and a loss on mortgage loans held-for-sale of $22,334, respectively. Included within the results for the three and six months ended June 30, 2012, we recognized $48,219 and $3,736 of gains on mortgage loans held-for-sale and $38,753 and $26,069 of losses on commitments to sell mortgage loans held-for-sale, respectively.

Other Income

For the three and six months ended June 30, 2013, we recorded other income of $1.8 million and $8.1 million, which includes $16.8 million and $24.8 million in unrealized losses on mortgage loans held-for-investment in securitization trust and $18.3 million and $32.6 million in unrealized gains on collateralized borrowings in securitization trust. Also included in other income for both the three and six months ended June 30, 2013 is servicing fee income and change in unrealized losses related to mortgage servicing rights.

Management Fees

We incurred management fees of $12.6 million and $21.7 million, respectively, for the three and six months ended June 30, 2013 and $7.6 million and $14.4 million for the three and six months ended June 30, 2012, which are payable to PRCM Advisers, our external manager, under our management agreement. The management fee is calculated based on our stockholders' equity with certain adjustments outlined in the management agreement. However, these fees were reduced by $40,000 and $4.3 million, respectively, on the condensed consolidated statements of comprehensive (loss) income for the three and six months ended June 30, 2013, in accordance with the contribution transaction entered into with Silver Bay. See further discussion of this adjustment in Note 23 - Related Party Transactions of the notes to the condensed consolidated financial statements.

Securitization Deal Costs

For the six months ended June 30, 2013, we recognized $2.0 million in upfront costs related to the subordinated debt and excess servicing rights acquired from a securitization trust issued by a third party, which was paid upon settlement of the acquisition. These costs are included when evaluating the economics of a securitization; however, the election of the fair value option for the assets and liabilities held in the securitization trust requires the expense to be recognized upfront on the condensed consolidated statements of comprehensive (loss) income.

Other Operating Expenses

For the three and six months ended June 30, 2013, we recognized $9.5 million and $16.0 million, respectively, of other operating expenses, which represents an annualized expense ratio of 0.9% and 0.8% of average equity, compared to $3.9 million and $7.5 million of expenses, which represents an annualized expense ratio of 0.7% and 0.8% of average equity, for the same periods in 2012. The increase of our operating expense ratio resulted primarily from an increase in expenses related to mortgage loan activities.

Included in other operating expenses are direct and allocated costs incurred by PRCM Advisers on our behalf and reimbursed by us. For the three and six months ended June 30, 2013, these direct and allocated costs totaled approximately $2.5 million and $4.5 million, compared to $1.7 million and $6.1 million of costs for the same periods in 2012. Included in these

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reimbursed costs was compensation paid to our executive officers, including our principal financial officer and general counsel of $0.2 million and $0.4 million for the three and six months ended June 30, 2013 and $0.1 million and $0.2 million for the three and six months ended June 30, 2012. The allocation of compensation paid to our principal financial officer and general counsel is based on time spent overseeing our company's activities in accordance with the management agreement. Equity based compensation expense for both the three and six months ended June 30, 2013 also includes the amortization of the restricted stock awarded to our executive officers in conjunction with the restated equity incentive plan (see discussion in Note 19 - Equity Incentive Plan), including our chief executive officer, chief investment officer, principal financial officer and general counsel of $0.3 million.

In April 2012, we established an accounts payable function and direct relationships with the majority of our third party vendors. We will continue to have certain costs allocated to us by PRCM Advisers for compensation, data services and proprietary technology, but most of our expenses with third party vendors are paid directly by us.

Income Taxes

For the three and six months ended June 30, 2013, we recognized a provision for income taxes of $49.1 million and $54.1 million, respectively, which was primarily incurred due to income generated from derivative instruments held in our TRSs. For the three and six months ended June 30, 2012 we recognized a benefit from income taxes of $16.6 million and $24.2 million, respectively. We currently intend to distribute 100% of our REIT taxable income and comply with all requirements to continue to qualify as a REIT.

Financial Condition

Available-for-Sale Securities, at Fair Value

Agency RMBS

Our Agency RMBS AFS portfolio is comprised of adjustable rate and fixed rate mortgage-backed securities backed by single-family and multi-family mortgage loans. All of our principal and interest Agency RMBS AFS were Fannie Mae or Freddie Mac mortgage pass-through certificates or collateralized mortgage obligations that carry an implied “AAA” rating, or Ginnie Mae mortgage pass-through certificates, which are backed by the guarantee of the U.S. Government. The majority of these securities consist of whole pools in which we own all of the investment interests in the securities.

The tables below summarize certain characteristics of our Agency RMBS AFS securities at June 30, 2013:

	June 30, 2013							
(dollars in thousands, except purchase price)	Principal/Current Face	Net (Discount)/ Premium	Amortized Cost	Unrealized Gain	Unrealized Loss	Carrying Value	Weighted Average Coupon Rate	Weighted Average Purchase Price
Principal and interest securities:								
Fixed	$11,049,746	$799,709	$11,849,455	$84,027	$(392,830)	$11,540,652	4.05 %	$107.98
Hybrid/ARM	161,036	8,164	169,200	1,818	(336)	170,682	3.74 %	$106.24
Total P&I Securities	11,210,782	807,873	12,018,655	85,845	(393,166)	11,711,334	4.04 %	$107.96
Interest-only securities								
Fixed	766,034	(687,812)	78,222	10,839	(2,815)	86,246	4.30 %	$13.23
Fixed Other [(1)]	1,814,450	(1,670,476)	143,974	4,787	(5,513)	143,248	1.68 %	$9.37
Total	$13,791,266	$(1,550,415)	$12,240,851	$101,471	$(401,494)	$11,940,828		

(1) Fixed Other represent weighted-average coupon interest-only securities that are not generally used for our interest-rate risk management purposes. These securities pay variable coupon interest based on the weighted average of the fixed rates of the underlying loans of the security, less the weighted average rates of the applicable issued principal and interest securities.

Our three-month average constant prepayment rate, or CPR, experienced by Agency RMBS AFS owned by us as of June 30, 2013, on an annualized basis, was 8.3%.

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The following table summarizes the number of months until the next re-set for our floating or adjustable rate Agency RMBS AFS mortgage portfolio at June 30, 2013:

(in thousands)	Carrying Value
0-12 months	$161,450
13-36 months	3,925
37-60 months	5,307
Greater than 60 months	—
Total	$170,682

Non-Agency RMBS

Our non-Agency RMBS portfolio is comprised of senior and mezzanine tranches of mortgage-backed securities. The following tables provide investment information on our non-Agency RMBS as of June 30, 2013:

	As of June 30, 2013						
(in thousands)	Principal/current face	Accretable purchase discount	Credit reserve purchase discount	Amortized cost	Unrealized gain	Unrealized loss	Carrying value
Principal and interest securities:							
Senior	$3,932,358	$(694,622)	$(1,270,976)	$1,966,760	$483,675	$(6,704)	$2,443,731
Mezzanine	702,444	(176,459)	(115,631)	410,354	92,912	(4,303)	498,963
Total P&I Securities	4,634,802	(871,081)	(1,386,607)	2,377,114	576,587	(11,007)	2,942,694
Interest-only securities	359,890	(351,537)	—	8,353	564	(124)	8,793
Total	$4,994,692	$(1,222,618)	$(1,386,607)	$2,385,467	$577,151	$(11,131)	$2,951,487

The majority of our non-Agency RMBS were rated at June 30, 2013. Note that credit ratings are based on the par value of the non-Agency RMBS, whereas the distressed non-Agency RMBS assets in our portfolio were acquired at a heavily discounted price. The following table summarizes the credit ratings of our non-Agency RMBS portfolio as of June 30, 2013:

	June 30, 2013
AAA	— %
AA	— %
A	— %
BBB	0.4 %
BB	1.1 %
B	8.1 %
Below B	85.9 %
Not rated	4.5 %
Total	100.0 %

Our non-Agency RMBS portfolio has increased approximately 1.5 times since June 30, 2012. However, our allocation of non-Agency RMBS to subprime securities has increased only slightly from 84.0% at June 30, 2012 to 87.1% at June 30, 2013. As a result, our designated credit reserve as a percentage of total discount and total face value has remained relatively constant (as disclosed in Note 5 - Available-for-Sale Securities, at Fair Value of the notes to the condensed consolidated financial statements). When focused on principal and interest securities, from June 30, 2012 to June 30, 2013, our designated credit reserve as a percentage of total discount increased minimally from 60.1% to 61.4% and our designated credit reserve as a percentage of total face value decreased slightly from 30.8% to 27.8%. As our allocation of non-Agency RMBS to subprime securities has remained relatively stable over the period from June 30, 2012 to June 30, 2013, we believe these comparable portfolio metrics are reflective of our consistent investment profile, regardless of portfolio growth.

A subprime bond may generally be considered higher risk; however, if purchased at a discount that reflects a high expectation of credit losses, it could be viewed less risky than a prime bond, which is subject to unanticipated credit loss performance. Accordingly, we believe our risk profile in owning a heavily discounted subprime bond with known delinquencies affords us the ability to assume a higher percentage of expected credit loss with comparable risk-adjusted returns to a less discounted prime bond with a lower percentage of expected credit loss.

The following tables present certain information detailed by investment type and their respective underlying loan characteristics for our senior and mezzanine non-Agency RMBS, excluding our non-Agency interest-only portfolio, at June 30, 2013:

	At June 30, 2013					
Non-Agency Principal and Interest (P&I) RMBS Characteristics	Senior Bonds		Mezzanine Bonds		Total P&I Bonds	
Carrying Value (in thousands)	$2,443,731		$498,963		$2,942,694	
% of Non-Agency Portfolio	83.0	%	17.0	%	100.0	%
Average Purchase Price (1)	$51.08		$57.45		$52.16	
Average Coupon	1.8	%	1.4	%	1.7	%
Average Fixed Coupon	5.5	%	5.6	%	5.5	%
Average Floating Coupon	1.0	%	1.2	%	1.1	%
Average Hybrid Coupon	4.4	%	—	%	4.4	%
Collateral Attributes						
Avg Loan Age (months)	81		100		85	
Avg Loan Size (in thousands)	$246		$189		$237	
Avg Original Loan-to-Value	77.0	%	75.5	%	76.7	%
Avg Original FICO (2)	616		637		620	
Current Performance						
60+ day delinquencies	35.1	%	30.0	%	34.2	%
Average Credit Enhancement (3)	11.4	%	26.2	%	13.9	%
3-Month CPR (4)	3.6	%	5.9	%	4.0	%

(1) Average purchase price utilized carrying value for weighting purposes. If current face were utilized for weighting purposes, the average purchase price for senior, mezzanine, and total non-Agency RMBS, excluding our non-Agency interest-only portfolio, would be $47.62, $55.39, and $48.80, respectively, at June 30, 2013.

(2) FICO represents a mortgage industry accepted credit score of a borrower, which was developed by Fair Isaac Corporation.

(3) Average credit enhancement remaining on our non-Agency RMBS portfolio, which is the average amount of protection available to absorb future credit losses due to defaults on the underlying collateral.

(4) Three-month CPR is reflective of the prepayment speed on the underlying securitization; however, it does not necessarily indicate the proceeds received on our investment tranche. Proceeds received for each security are dependent on the position of the individual security within the structure of each deal.

Non-Agency RMBS Characteristics	June 30, 2013								
(dollars in thousands)	Senior Bonds			Mezzanine Bonds			Total Bonds		
Loan Type	Carrying Value	% of Senior Bonds		Carrying Value	% of Mezzanine Bonds		Carrying Value	% of Non-Agency Portfolio	
Prime	$39,278	1.6	%	$12,593	2.5	%	$51,871	1.8	%
Alt-A	93,499	3.8	%	25,139	5.0	%	118,638	4.0	%
POA	200,725	8.2	%	9,418	1.9	%	210,143	7.1	%

Subprime	2,110,229	86.4	%	451,813	90.6	%	2,562,042	87.1	%
	$2,443,731	100.0	%	$498,963	100.0	%	$2,942,694	100.0	%

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Non-Agency RMBS Characteristics	June 30, 2013					
(dollars in thousands)	Senior Bonds		Mezzanine Bonds		Total Bonds	
Coupon Type	Carrying Value	% of Senior Bonds	Carrying Value	% of Mezzanine Bonds	Carrying Value	% of Non-Agency Portfolio
Fixed Rate	$389,275	15.9 %	$18,745	3.8 %	$408,020	13.9 %
Hybrid or Floating	2,054,456	84.1 %	480,218	96.2 %	2,534,674	86.1 %
	$2,443,731	100.0 %	$498,963	100.0 %	$2,942,694	100.0 %

Non-Agency RMBS Characteristics	June 30, 2013					
(dollars in thousands)	Senior Bonds		Mezzanine Bonds		Total Bonds	
Loan Origination Year	Carrying Value	% of Senior Bonds	Carrying Value	% of Mezzanine Bonds	Carrying Value	% of Non-Agency Portfolio
2006+	$1,951,144	79.8 %	$40,271	8.1 %	$1,991,415	67.7 %
2002-2005	488,785	20.0 %	451,923	90.5 %	940,708	31.9 %
Pre-2002	3,802	0.2 %	6,769	1.4 %	10,571	0.4 %
	$2,443,731	100.0 %	$498,963	100.0 %	$2,942,694	100.0 %

Trading Securities, at Fair Value

We hold U.S. Treasuries in a taxable REIT subsidiary and classify these securities as trading instruments due to short-term investment objectives. As of June 30, 2013, we held U.S. Treasuries with an amortized cost of $1.0 billion and a fair value of $1.0 billion classified as trading securities. The unrealized gains included within trading securities were $3.5 million as of June 30, 2013.

Mortgage Loans Held-for-Sale, at Fair Value

In late 2011, we began acquiring prime nonconforming residential mortgage loans from select mortgage loan originators and secondary market institutions with whom we have chosen to build strategic relationships, including those with a nationwide presence. As of June 30, 2013, we held prime nonconforming residential mortgage loans with a carrying value of $520.0 million and have outstanding purchase commitments to acquire an additional $29.2 million. Our intention in the future is to securitize these loans and/or exit through a whole loan sale.

In early 2013, we began acquiring credit sensitive loans, or CSLs, which are loans that are currently performing, but where the borrower has previously experienced payment delinquencies and is more likely to be underwater (i.e., the amount owed on a mortgage loan exceeds the current market value of the home). As a result, there is a higher probability of default than on newly originated mortgage loans. As of June 30, 2013, we had acquired credit sensitive residential mortgage loans with a carrying value of $438.2 million. Our intention in the future is to either securitize these loans or hold them in an alternative financing structure.

The following table presents our mortgage loans held-for-sale portfolio by loan type as of June 30, 2013:

	June 30, 2013			
(in thousands)	Unpaid Principal Balance	Fair Value - Purchase Price	Fair Value - Unrealized	Carrying Value
Prime nonconforming residential mortgage loans	$528,067	$(5,872)	$(2,187)	$520,008
Credit sensitive residential mortgage loans	573,322	(136,303)	1,174	438,193
Mortgage loans held-for-sale	$1,101,389	$(142,175)	$(1,013)	$958,201

Mortgage Loans Held-for-Investment in Securitization Trust, at Fair Value

During the six months ended June 30, 2013, we purchased subordinated debt and excess servicing rights from a securitization trust issued by a third party. The underlying residential mortgage loans held at the trust, which are consolidated on the Company's condensed consolidated balance sheet, are classified as mortgage loans held-for-investment in securitization trust and carried at fair value as a result of a fair value option election. See Note 3 - Variable Interest Entities to the Condensed

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Consolidated Financial Statements for additional information regarding consolidation of the securitization trust. As of June 30, 2013 the mortgage loans held-for-investment in securitization trust had a carrying value of $401.3 million.
Repurchase Agreements
Our borrowings consist primarily of repurchase agreements collateralized by our pledge of AFS and trading securities, derivative instruments, mortgage loans and certain cash balances. Substantially all of our Agency RMBS AFS are currently pledged as collateral, and the majority of our non-Agency RMBS have been pledged. As of June 30, 2013, our debt-to-equity ratio was 4.0:1.0, including the debt collateralized by our U.S. Treasuries, residential mortgage loans and Agency derivatives. Our debt-to-equity ratio for RMBS, mortgage loans held-for-sale and Agency derivatives only was 3.6:1.0. We believe our debt-to-equity ratio provides unused borrowing capacity and, thus, improves our liquidity and the strength of our balance sheet.
As of June 30, 2013, the term to maturity of our borrowings ranged from nine days to over 36 months. The weighted average original term to maturity of our borrowings collateralized by RMBS and mortgage loans was 86 days at June 30, 2013. At June 30, 2013, the weighted average cost of funds for all our repurchase agreements was 0.67%.

(dollars in thousands)	June 30, 2013					December 31, 2012				
Collateral Type	Amount Outstanding	Weighted Average Borrowing Rate		Weighted Average Haircut on Collateral Value		Amount Outstanding	Weighted Average Borrowing Rate		Weighted Average Haircut on Collateral Value	
U.S. Treasuries	$1,000,000	0.08	%	0.3	%	$997,500	0.30	%	0.5	%
Agency RMBS AFS	11,828,514	0.46	%	5.4	%	10,171,385	0.54	%	5.6	%
Non-Agency RMBS	1,421,285	2.23	%	34.7	%	1,177,675	2.50	%	35.5	%
Agency derivatives	219,235	1.07	%	27.3	%	228,241	1.16	%	26.5	%
Mortgage loans held-for-sale	434,121	2.69	%	10.2	%	49,709	2.46	%	10.8	%
Total	$14,903,155	0.67	%	8.3	%	$12,624,510	0.72	%	8.4	%

The following table provides the quarterly average balances, the quarter-end balances, and the maximum balances at any month-end within that quarterly period, of repurchase agreements for the three months ended June 30, 2013, and the four immediately preceding quarters:

(dollars in thousands)	Quarterly Average Repurchase Balances (1)	End of Period Balance Repurchase Agreements (1)	Maximum Balance of Any Month-End for Repurchase Agreements (1)	Repurchase Agreements to Equity Ratio	
For the Three Months Ended June 30, 2013	$13,362,585	$13,903,155	$13,903,155	3.6	:1.0(2)
For the Three Months Ended March 31, 2013	$12,287,326	$12,439,565	$12,460,525	3.1	:1.0(3)
For the Three Months Ended December 31, 2012	$12,725,330	$11,627,010	$13,073,597	3.4	:1.0(4)
For the Three Months Ended September 30, 2012	$11,271,401	$13,036,827	$13,036,827	3.8	:1.0(5)
For the Three Months Ended June 30, 2012	$8,526,166	$9,440,941	$9,440,941	4.3	:1.0

(1) Includes repurchase agreements collateralized by RMBS AFS, residential mortgage loans held-for-sale and Agency derivatives and excludes repurchase agreements collateralized by U.S. Treasuries and collateralized borrowings in securitization trust.

(2) Due to the rising rate environment during the three months ended June 30, 2013, we reduced leverage on our Agency RMBS and held a higher amount of cash on hand in order to protect stockholders' equity from a near term widening of spreads and rates in the marketplace. However, over a longer timeframe, we will likely continue to target an overall debt-to-equity ratio of 4.0:1.0 to 4.5:1.0.

(3) On March 22, 2013, we completed a capital raise of approximately $762.9 million in net proceeds. Due to the timing of the capital raise within the quarter, the net proceeds were only partially invested, on a leveraged basis, as of March 31, 2013. With a higher targeted allocation to non-Agency RMBS for additional capital, we targeted a fully deployed debt-to-equity ratio of 4.0:1.0 to 4.5:1.0.

(4) During the three months ended December 31, 2012, we sold Agency RMBS with an amortized cost of $3.1 billion. Due to higher Agency RMBS valuation and inherently tighter spreads during the quarter, we chose to delay deployment of a portion of these proceeds and reduce leverage in order to protect stockholders' equity from a near term widening of spreads in the marketplace. However, we continue to target an overall debt-to-equity ratio of 4.0:1.0 to 4.5:1.0.

(5) In September 2012, warrantholders exercised 16.2 million shares generating proceeds of $175.7 million, which were invested on a leveraged basis. With a higher targeted allocation to Agency RMBS and residential properties for additional capital, we targeted a fully deployed debt-to-equity ratio of 4.0:1.0 to 4.5:1.0.

Collateralized Borrowings in Securitization Trust, at Fair Value

During the six months ended June 30, 2013, we purchased subordinated debt and excess servicing rights from a securitization trust issued by a third party. The underlying debt held at the trust, which is consolidated on the Company's condensed consolidated balance sheet, is classified as collateralized borrowings in securitization trust and carried at fair value as a result of a fair value option election. See Note 3 - Variable Interest Entities to the Condensed Consolidated Financial Statements for additional information regarding consolidation of the securitization trust. As of June 30, 2013, the collateralized borrowings in securitization trust had a carrying value of $363.0 million with a weighted average interest rate of 2.2%. The stated maturity dates for all collateralized borrowings are greater than five years from June 30, 2013.

Equity

As of June 30, 2013, our stockholders' equity was $3.8 billion and our diluted book value per share was $10.47. As of March 31, 2013, our stockholders' equity was $4.1 billion and our diluted book value per share was $11.19.

The following table provides details of our changes in stockholders' equity from March 31, 2013 to June 30, 2013:

(dollars in millions, except per share amounts)	Book Value	Common Shares Outstanding	Book Value Per Common Share
Stockholders' equity at March 31, 2013 - basic	$4,065.1	362.1	$11.23
GAAP net income:			
Core Earnings, net of tax benefit of $0.2 million [1]	78.1		
Realized gains, net of tax expense of $8.9 million	83.4		
Unrealized mark-to-market gains, net of tax expense of $40.4 million	226.1		
Discontinued operations	1.0		
Total GAAP net income	388.6		
Other comprehensive loss	(534.7)		
Dividend declaration	(113.4)		
Other	1.0	1.0	
Balance before capital transactions	3,806.6	363.1	
Repurchase of common stock	(10.5)	(1.0)	
Net proceeds from issuance of common stock	0.2	0.1	
Proceeds from issuance of common stock through warrant exercise	37.8	3.5	
Stockholders' equity at June 30, 2013 - basic	3,834.1	365.7	10.48
Warrants outstanding [2]	—	0.3	(0.01)
Stockholders' equity at June 30, 2013 - diluted	$3,834.1	366.0	$10.47

(1) Core Earnings is a non-GAAP measure that we define as net income, excluding impairment losses, gains or losses on sales of securities and termination of interest rate swaps, unrealized gains or losses on trading securities, interest rate swaps and swaptions, certain gains or losses on other derivative instruments, certain non-recurring gains and losses related to discontinued operations, and certain non-recurring upfront costs related to securitization transactions. As defined, Core Earnings includes interest income associated with our inverse interest-only securities, or Agency derivatives, and premium income or loss on credit default swaps. Core Earnings is provided for purposes of comparability to other peer issuers.

(2) Using the treasury stock method, 0.3 million shares would be considered outstanding and dilutive to book value per share at June 30, 2013.

Liquidity and Capital Resources

Our liquidity and capital resources are managed and forecast on a daily basis to ensure that we have sufficient liquidity to absorb market events that could negatively impact collateral valuations and result in margin calls and to ensure that we have the flexibility to manage our portfolio to take advantage of market opportunities.

Our principal sources of cash consist of borrowings under repurchase agreements, payments of principal and interest we receive on our RMBS portfolio, cash generated from our operating results, and proceeds from capital market transactions. We typically use cash to repay principal and interest on our repurchase agreements, to purchase our target assets, to make dividend payments on our capital stock, and to fund our operations.

To the extent that we raise additional equity capital through capital market transactions, we anticipate using cash proceeds from such transactions to purchase additional RMBS, mortgage loans, and other target assets and for other general corporate purposes. There can be no assurance, however, that we will be able to raise additional equity capital at any particular time or on any particular terms.

As of June 30, 2013, we held $0.9 billion in cash and cash equivalents available to support our operations, $18.0 billion of AFS, trading securities, equity securities, mortgage loans held-for-sale, mortgage loans held-for-investment in securitization trust, and derivative assets held at fair value, and $15.3 billion of outstanding debt in the form of repurchase agreements and collateralized borrowings in securitization trust (excludes $62.8 million in payables to broker counterparties for unsettled security purchases). During the three months ended June 30, 2013, our debt-to-equity ratio increased from 3.4:1.0 to 4.0:1.0, including monies borrowed to finance our investment in U.S. Treasuries and collateralized borrowings in securitization trust. The debt-to-equity ratio funding our RMBS AFS, mortgage loans held-for-sale, and Agency derivatives increased from 3.1:1.0 to 3.6:1.0 as we continued to deploy proceeds from our stock offering and warrant exercises. We believe the debt-to-equity ratio funding our RMBS AFS, mortgage loans held-for-sale and Agency derivatives is the most meaningful debt-to-equity measure as U.S. Treasuries are viewed to be highly liquid in nature and collateralized borrowings on mortgage loans held-for-investment in securitization trust represents term financing with no stated maturity.

As of June 30, 2013, we had approximately $44.7 million of unpledged Agency RMBS AFS and Agency derivatives and $634.2 million of unpledged non-Agency securities and an overall estimated unused borrowing capacity on unpledged RMBS of approximately $398.3 million. We also had approximately $45.0 million of unpledged prime nonconforming residential mortgage loans and $438.2 million of unpledged credit sensitive residential mortgage loans and an overall estimated unused borrowing capacity on unpledged mortgage loans held-for-sale of approximately $281.5 million. On a daily basis, we monitor and forecast our available, or excess, liquidity. Additionally, we frequently perform shock analyses against various market events to monitor the adequacy of our excess liquidity. If borrowing rates and collateral requirements change in the near term, we believe we are subject to less earnings volatility than a more leveraged organization.

We have not experienced any restrictions to our funding sources to date and have generally experienced an increase in available financing in the RMBS marketplace, including repurchase agreements with maturities greater than one year. We expect ongoing sources of financing to be primarily repurchase agreements and similar financing arrangements. We plan to finance our assets with a moderate amount of leverage, the level of which may vary based upon the particular characteristics of our portfolio and market conditions. We may deploy, on a debt-to-equity basis, up to ten times leverage on our Agency RMBS assets. We also deploy some leverage on our non-Agency RMBS assets utilizing repurchase agreements as the source of financing.

As of June 30, 2013, we have master repurchase agreements in place with 24 counterparties, the majority of which are U.S. domiciled financial institutions, and we continue to evaluate further counterparties to manage and reduce counterparty risk. Under our repurchase agreements, we are required to pledge additional assets as collateral to our counterparties (lenders) when the estimated fair value of the existing pledged collateral under such agreements declines and such lenders, through a margin call, demand additional collateral. Lenders generally make margin calls because of a perceived decline in the value of our assets collateralizing the repurchase agreements. This may occur following the monthly principal reduction of assets due to scheduled amortization and prepayments on the underlying mortgages, or may be caused by changes in market interest rates, a perceived decline in the market value of the investments and other market factors. To cover a margin call, we may pledge additional securities or cash. At maturity, any cash on deposit as collateral is generally applied against the repurchase agreement balance, thereby reducing the amount borrowed. Should the value of our assets suddenly decrease, significant margin calls on our repurchase agreements could result, causing an adverse change in our liquidity position.

The following table summarizes our repurchase agreements and counterparty geographical concentration at June 30, 2013 and December 31, 2012:

	June 30, 2013			December 31, 2012		
(dollars in thousands)	Amount Outstanding	Net Counterparty	Percent of Funding	Amount Outstanding	Net Counterparty	Percent of Funding

		Exposure(1)				Exposure(1)		
North America	$8,982,439	$791,280	49.8	%	$7,550,085	$958,119	57.4	%
Europe (2)	3,817,889	679,910	42.8	%	3,032,331	593,184	35.6	%
Asia (2)	2,102,827	118,005	7.4	%	2,042,094	116,245	7.0	%
Total	$14,903,155	$1,589,195	100.0	%	$12,624,510	$1,667,548	100.0	%

(1) Represents the net carrying value of the securities or mortgage loans sold under agreements to repurchase, including accrued interest plus any cash or assets on deposit to secure the repurchase obligation, less the amount of the repurchase liability, including accrued interest. At June 30, 2013 and December 31, 2012, we had $62.8 million and $291.7 million, respectively, in payables due to broker counterparties for unsettled security purchases. The payables are not included in the amounts presented above.

(2) Exposure to European and Asian domiciled banks and their U.S. subsidiaries.

In addition to our master repurchase agreements to fund RMBS, we have entered into three facilities that provide short-term financing for our mortgage loan collateral during our aggregation period. An overview of the facilities is presented in the table below:
(dollars in thousands)
As of June 30, 2013

Expiration Date		Committed	Amount Outstanding	Unused Capacity	Total Capacity	Eligible Collateral
September 26, 2013	(1)	Yes	$413,787	$—	$413,787	Prime nonconforming residential mortgage loans
May 13, 2014	(2)	No	20,334	79,666	100,000	Prime nonconforming residential mortgage loans
May 22, 2014	(3)	No	—	200,000	200,000	Prime nonconforming residential mortgage loans Credit sensitive residential mortgage loans

(1) The facility is set to mature on the stated expiration date, or securitization date of respective collateral, whichever comes first.
(2) The facility is set to mature on the stated expiration date, unless extended pursuant to its terms.

We are subject to the following financial covenants under these lending agreements, as further detailed by the guaranty agreements we entered into in connection with the repurchase agreements. The following represents the most restrictive covenant calculations as of June 30, 2013 across these agreements:

(a) As of the last business day of each calendar quarter, Total Indebtedness to Net Worth must be less than the specified Threshold Ratio in the Repurchase Agreement. As of June 30, 2013, our debt to net worth, as defined, was 3.8:1.0 while our threshold ratio, as defined, was 6.0:1.0.
(b) As of the last business day of each calendar quarter, Liquidity must be greater than 100 bps of Total Assets, or $196.4 million at June 30, 2013, and the aggregate amount of Unrestricted Cash or Cash Equivalents must be greater than 75 bps of Total Assets, or $147.3 million at June 30, 2013. As of June 30, 2013, our liquidity, as defined, was $917.2 million and our total unrestricted cash and cash equivalents, as defined, was $451.7 million.
(c) As of the last business day of each calendar quarter, Net Worth must be greater than $1 billion. As of June 30, 2013, our net worth, as defined, was $3.8 billion.

We are also subject to financial covenants in connection with various other repurchase agreements we enter into in the normal course of our business. We intend to continue to operate in a manner which complies with all of our financial covenants.

The following table summarizes assets at carrying value that are pledged or restricted as collateral for the future payment obligations of repurchase agreements.

(in thousands)	June 30, 2013	December 31, 2012
Available-for-sale securities, at fair value	$14,153,148	$12,810,355
Trading securities, at fair value	1,001,172	1,002,062
Mortgage loans held-for-sale	475,028	52,529
Cash and cash equivalents	15,000	10,000
Restricted cash	596,479	84,307
Due from counterparties	15,373	36,917

Derivative assets, at fair value	239,293	291,054
Total	$16,495,493	$14,287,224

Although we generally intend to hold our target assets as long-term investments, we may sell certain of our investment securities in order to manage our interest rate risk and liquidity needs, to meet other operating objectives and to adapt to market conditions. We cannot predict the timing and impact of future sales of investment securities, if any. Because many of our investment securities are financed with repurchase agreements and may be financed with credit facilities (including term loans

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and revolving facilities), a significant portion of the proceeds from sales of our investment securities (if any), prepayments and scheduled amortization are used to repay balances under these financing sources.

The following table provides the maturities of our repurchase agreements as of June 30, 2013 and December 31, 2012:

(in thousands)	June 30, 2013	December 31, 2012
Within 30 days	$4,751,482	$3,038,229
30 to 59 days	2,937,677	3,528,393
60 to 89 days (1)	889,141	1,731,595
90 to 119 days	1,553,211	849,621
120 to 364 days (2)	3,571,644	2,279,172
Open maturity (3)	1,000,000	997,500
One year and over (4)	200,000	200,000
Total	$14,903,155	$12,624,510

(1) 60 to 89 days includes the amounts outstanding under the secured loan facility.

(2) 120 to 364 days includes the amounts outstanding under the uncommitted mortgage loan warehouse facility.

(3) Repurchase agreements collateralized by U.S. Treasuries include an open maturity period (i.e., rolling 1-day maturity) renewable at the discretion of either party to the agreements.

(4) One year and over includes repurchase agreements with maturity dates ranging from June 26, 2015 to July 27, 2016.

For the three months ended June 30, 2013, our unrestricted cash balance decreased to $917.2 million from $1.1 billion at March 31, 2013. The cash movements can be summarized by the following:

- Cash flows from operating activities. For the three months ended June 30, 2013, operating activities decreased our cash balances by approximately $663.8 million, primarily driven by our financial results for the quarter and purchases of mortgage loans held-for-sale.
- Cash flows from investing activities. For the three months ended June 30, 2013, investing activities reduced our cash balances by approximately $913.1 million. The reduction was driven by the increase in our RMBS portfolio as we continued to deploy capital from our common stock offerings and exercise of outstanding warrants.
- Cash flows from financing activities. For the three months ended June 30, 2013, financing activities increased our cash balance by approximately $1.4 billion, resulting from the net borrowings under repurchase agreements to fund our AFS portfolio as well as proceeds of $27.5 million received from exercise of outstanding warrants, net of common stock repurchases.

Inflation

Substantially all of our assets and liabilities are financial in nature. As a result, changes in interest rates and other factors impact our performance far more than does inflation. Our financial statements are prepared in accordance with GAAP and dividends are based upon net ordinary income and capital gains as calculated for tax purposes; in each case, our results of operations and reported assets, liabilities and equity are measured with reference to historical cost or fair value without considering inflation.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We seek to manage our risks related to the credit quality of our assets, interest rates, liquidity, prepayment speeds and market value while providing an opportunity to stockholders to realize attractive risk-adjusted returns through ownership of our capital stock. Although we do not seek to avoid risk completely, we believe that risk can be quantified from historical experience and we seek to manage our risk levels in order to earn sufficient compensation to justify the risks we undertake and to maintain capital levels consistent with taking such risks.

To reduce the risks to our portfolio, we employ portfolio-wide and security-specific risk measurement and management processes in our daily operations. PRCM Advisers' risk management tools include software and services licensed or purchased from third parties, in addition to proprietary software and analytical methods developed by Pine River. There can be no guarantee that these tools will protect us from market risks.

Interest Rate Risk

Interest rates are highly sensitive to many factors, including fiscal and monetary policies and domestic and international economic and political considerations, as well as other factors beyond our control. We are subject to interest rate risk in connection with our assets and related financing obligations. Subject to maintaining our qualification as a REIT, we engage in a variety of interest rate management techniques that seek to mitigate the influence of interest rate changes on the values of our assets.

We utilize U.S. Treasuries as well as derivative financial instruments, currently limited to interest rate swaps, swaptions, TBAs, put and call options for TBAs, constant maturity swaps, commitments to purchase mortgage loans held-for-sale and, to a certain extent, inverse interest-only securities, as of June 30, 2013, to hedge the interest rate risk associated with our portfolio. We seek to hedge interest rate risk with respect to both the fixed income nature of our assets and the financing of our portfolio. In hedging interest rates with respect to our fixed income assets, we seek to reduce the risk of losses on the value of our investments that may result from changes in interest rates in the broader markets. In utilizing interest rate hedges with respect to our financing, we seek to improve risk-adjusted returns and, where possible, to obtain a favorable spread between the yield on our assets and the cost of our financing. We rely on PRCM Advisers' expertise to manage these risks on our behalf. We implement part of our hedging strategy through one of our TRSs, which is subject to U.S. federal, state and, if applicable, local income tax.

Interest Rate Effect on Net Interest Income

Our operating results depend in large part on differences between the income earned on our assets and our cost of borrowing and hedging activities. The costs associated with our borrowings are generally based on prevailing market interest rates. During a period of rising interest rates, our borrowing costs generally will increase while the yields earned on our existing portfolio of leveraged fixed-rate RMBS and mortgage loans held-for-sale will remain static. Moreover, interest rates may rise at a faster pace than the yields earned on our leveraged adjustable-rate and hybrid RMBS and adjustable-rate mortgage loans held-for-sale. Both of these factors could result in a decline in our net interest spread and net interest margin. The severity of any such decline would depend on our asset/liability composition at the time, as well as the magnitude and duration of the interest rate increase. Further, an increase in short-term interest rates could also have a negative impact on the market value of our target assets. If any of these events happen, we could experience a decrease in net income or incur a net loss during these periods, which could adversely affect our liquidity and results of operations.

Our hedging techniques are partly based on assumed levels of prepayments of our target assets. If prepayments are slower or faster than assumed, the life of the investment 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.

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

We also acquire adjustable-rate mortgage loans held-for-sale. These assets are typically subject to periodic and lifetime interest rate caps and floors, which may limit the amount by which the loan's interest yield may change during any given period. However, our borrowing costs pursuant to our financing agreements are not subject to similar restrictions. Therefore, in a period of increasing interest rates, interest rate costs on our borrowings could increase without limitation, while the interest-rate yields on our adjustable-rate mortgage loans held-for-sale could effectively be limited by caps.

Interest Rate Mismatch Risk

We fund the majority of our adjustable-rate and hybrid Agency RMBS and adjustable-rate mortgage loans held-for-sale with borrowings that are based on LIBOR, while the interest rates on these assets may be indexed to other index rates, such as the one-year Constant Maturity Treasury index, or CMT, the Monthly Treasury Average index, or MTA, or the 11^{th} District Cost of Funds Index, or COFI. Accordingly, any increase in LIBOR relative to these indices may result in an increase in our borrowing costs that is not matched by a corresponding increase in the interest earnings on these assets. Any such interest rate index mismatch could adversely affect our profitability, which may negatively impact distributions to our stockholders. To mitigate interest rate mismatches, we utilize the hedging strategies discussed above.

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The following table provides the indices of our variable rate RMBS AFS and mortgage loans held-for-sale as of June 30, 2013 and December 31, 2012, respectively, based on carrying value (dollars in thousands).

	As of June 30, 2013					As of December 31, 2012				
Index Type	Floating	Hybrid [(1)]	Total	Index %		Floating	Hybrid [(1)]	Total	Index %	
CMT	$12,696	$143,625	$156,321	6	%	$—	$154,948	$154,948	6	%
LIBOR	2,517,777	30,055	2,547,832	92	%	2,313,283	28,747	2,342,030	93	%
Other [(2)]	57,560	12,113	69,673	2	%	18,334	8,066	26,400	1	%
Total	$2,588,033	$185,793	$2,773,826	100	%	$2,331,617	$191,761	$2,523,378	100	%

(1) "Hybrid" amounts reflect those assets with greater than 12 months to reset.
(2) "Other" includes COFI, MTA and other indices.

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

We use a variety of recognized industry models, as well as proprietary models, to perform sensitivity analyses which are derived from primary assumptions for prepayment rates, discount rates and credit losses. The primary assumption used in this model is implied market volatility of interest rates. The information presented in the following interest sensitivity table projects the potential impact of sudden parallel changes in interest rates on our financial results and financial condition over the next 12 months, based on our interest sensitive financial instruments at June 30, 2013. All changes in value are measured as the change from the June 30, 2013 financial position. All projected changes in annualized net interest income are measured as the change from the projected annualized net interest income based off current performance returns.

	Changes in Interest Rates							
(dollars in thousands)	-100 bps		-50 bps		+50 bps		+100 bps	
Change in value of financial position:								
Available-for-sale securities	$480,647		$250,050		$(376,940	)	$(780,528	)
As a % of June 30, 2013 equity	12.5	%	6.5	%	(9.8	)%	(20.3	)%
Trading securities	$5,099		$5,099		$(8,225	)	$(16,451	)
As a % of June 30, 2013 equity	0.1	%	0.1	%	(0.2	)%	(0.4	)%
Mortgage loans held-for-sale	$22,690		$14,027		$(19,968	)	$(45,216	)
As a % of June 30, 2013 equity	0.6	%	0.4	%	(0.5	)%	(1.2	)%
Mortgage loans held-for-investment in securitization trust	$17,425		$10,772		$(15,334	)	$(34,722	)
As a % of June 30, 2013 equity	0.5	%	0.3	%	(0.4	)%	(0.9	)%
Derivatives, net	$(807,598	)	$(454,275	)	$553,465		$1,185,881	
As a % of June 30, 2013 equity	(21.1	)%	(11.8	)%	14.4	%	30.9	%
Repurchase Agreements	$(10,128	)	$(10,074	)	$14,311		$28,622	
As a % of June 30, 2013 equity	(0.3	)%	(0.3	)%	0.4	%	0.7	%
Collateralized borrowings in securitization trust	$(24,836	)	$(16,727	)	$19,039		$41,823	
As a % of June 30, 2013 equity	(0.6	)%	(0.4	)%	0.5	%	1.1	%
Total Net Assets	$(316,701	)	$(201,128	)	$166,348		$379,409	
As a % of June 30, 2013 total assets	(1.6	)%	(1.0	)%	0.8	%	1.9	%
As a % of June 30, 2013 equity	(8.3	)%	(5.2	)%	4.4	%	9.9	%
	-100 bps		-50 bps		+50 bps		+100 bps	

Change in annualized net interest income:	$(21,263)	$(21,414)	$36,292	$72,584
% change in net interest income	(5.0)%	(5.1)%	8.6%	17.2%

The interest rate sensitivity table quantifies the potential changes in net interest income and portfolio value, which includes the value of swaps and our other derivatives, should interest rates immediately change. The interest rate sensitivity table presents the estimated impact of interest rates instantaneously rising 50 and 100 basis points, and falling 50 and 100 basis points. The cash flows associated with the portfolio of RMBS for each rate change are calculated based on assumptions, including prepayment speeds, yield on future acquisitions, slope of the yield curve, and size of the portfolio. Assumptions made on the interest rate sensitive liabilities, which are assumed to relate to repurchase agreements, including anticipated interest rates, collateral requirements as a percent of the repurchase agreement, amount and term of borrowing.

The available-for-sale securities and mortgage loans held-for-sale included in the foregoing interest rate sensitivity table under “change in value of financial position” were limited to Agency RMBS and prime jumbo mortgage loans. Due to the significantly discounted prices and underlying credit risks of our non-Agency RMBS and credit sensitive mortgage loans, we believe these assets are less sensitive to changes in interest rates. Although there may be some rate sensitivity, we cannot project the potential impact due to the lack of historical data and our view that the price sensitivity of these assets is driven largely by the credit performance of the underlying loans. We will continue to evaluate the interest rate sensitivity of our non-Agency RMBS and credit sensitive mortgage loans in future reporting periods. These non-Agency RMBS and credit sensitive mortgage loans have been included in the “change in annualized net interest income” analysis.

Certain assumptions have been made in connection with the calculation of the information set forth in the foregoing interest rate sensitivity table and, as such, there can be no assurance that assumed events will occur or that other events will not occur that would affect the outcomes. The base interest rate scenario assumes interest rates at June 30, 2013. The analysis utilizes assumptions and estimates based on management's judgment and experience. Furthermore, while we generally expect to retain such assets and the associated interest rate risk to maturity, future purchases and sales of assets could materially change our interest rate risk profile.

The change in annualized net interest income does not include any benefit or detriment from faster or slower prepayment rates on our Agency premium RMBS, non-Agency discount RMBS, and instruments that represent the interest payments (but not the principal) on a pool of mortgages, or interest-only securities. We anticipate that faster prepayment speeds in lower interest rate scenarios will generate lower realized yields on Agency and non-Agency premium and interest-only securities and higher realized yields on Agency and non-Agency discount RMBS. Similarly, we anticipate that slower prepayment speeds in higher interest rate scenarios will generate higher realized yields on Agency premium and interest-only bonds and lower realized yields on non-Agency discount RMBS. Although we have sought to construct the portfolio to limit the effect of changes in prepayment speeds, there can be no assurance this will actually occur, and the realized yield of the portfolio may be significantly different than we anticipate in changing interest rate scenarios.

Given the low interest rates at June 30, 2013, we applied a floor of 0% for all anticipated interest rates included in our assumptions. Because of this floor, we anticipate that any hypothetical interest rate shock decrease would have a limited positive impact on our funding costs; however, because prepayments speeds are unaffected by this floor, we expect that any increase in our prepayment speeds (occurring as a result of any interest rate decrease or otherwise) could result in an acceleration of our premium amortization on Agency and interest-only securities purchased at a premium, and accretion of discount on our non-Agency RMBS purchased at a discount. As a result, because this floor limits the positive impact of any interest rate decrease on our funding costs, hypothetical interest rate decreases could cause the fair value of our financial instruments and our net interest income to decline.

The information set forth in the interest rate sensitivity table and all related disclosures constitutes forward-looking statements within the meaning of Section 27A of the Securities Act, and Section 21E of the Exchange Act. Actual results could differ significantly from those estimated in the foregoing interest rate sensitivity table.

Prepayment Risk

Prepayment risk is the risk that principal will be repaid at a different rate than anticipated. As we receive prepayments of principal on our assets, premiums paid on such assets will be amortized against interest income. In general, an increase in prepayment rates will accelerate the amortization of purchase premiums, thereby reducing the interest income earned on the assets. Conversely, discounts on such assets 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 assets.

Normally, we believe that we will be able to reinvest proceeds from scheduled principal payments and prepayments at acceptable yields; however, no assurances can be given that, should significant prepayments occur, market conditions would be such that acceptable investments could be identified and the proceeds timely reinvested.

Market Risk

Market Value Risk. Our AFS securities are reflected at their estimated fair value, with the difference between amortized cost and estimated fair value reflected in accumulated other comprehensive income. The estimated fair value of these securities fluctuates primarily due to changes in interest rates, market valuation of credit risks, and other factors. Generally, in a rising interest rate environment, we would expect the fair value of these securities to decrease; conversely, in a decreasing interest rate environment, we would expect the fair value of these securities to increase. As market volatility increases or liquidity decreases, the fair value of our assets may be adversely impacted.

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Our mortgage loans held-for-sale and held-for-investment are reflected at their estimated fair value. The estimated fair value fluctuates primarily due to changes in interest rates, market valuation of credit risks and other factors. Generally in a rising rate environment, we would expect the fair value of these loans to decrease; conversely, in a decreasing rate environment, we would expect the fair value of these loans to increase. However, the fair value of the credit sensitive loans included in mortgage loans held-for-sale is generally not sensitive to interest rate changes.

Real estate risk. RMBS and residential property values are subject to volatility and may be affected adversely by a number of factors, including national, regional and local economic conditions; local real estate conditions (such as an oversupply of housing); changes or continued weakness in specific industry segments; construction quality, age and design; demographic factors; and retroactive changes to building or similar codes. Decreases in property values reduce the value of the collateral for mortgage loans and the potential proceeds available to borrowers to repay the loans, which could cause us to suffer losses on our non-Agency RMBS investments and mortgage loans.

Liquidity Risk

Our liquidity risk is principally associated with our financing of long-maturity assets with short-term borrowings in the form of repurchase agreements. Although the interest rate adjustments of these assets and liabilities fall within the guidelines established by our operating policies, maturities are not required to be, nor are they, matched.

Should the value of our assets pledged as collateral suddenly decrease, margin calls relating to our repurchase agreements could increase, causing an adverse change in our liquidity position. Additionally, if one or more of our repurchase agreement counterparties chose not to provide on-going funding, our ability to finance would decline or exist at possibly less advantageous terms. As such, we cannot assure that we will always be able to roll over our repurchase agreements. See Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources" in this Quarterly Report on Form 10-Q for further information about our liquidity and capital resource management.

Credit Risk

We believe that our investment strategy will generally keep our risk of credit losses low to moderate. However, we retain the risk of potential credit losses on all of the loans underlying our non-Agency RMBS and on our mortgage loans. With respect to our non-Agency RMBS that are senior in the credit structure, credit support contained in RMBS deal structures provide a level of protection from losses. We seek to manage the remaining credit risk through our pre-acquisition due diligence process, and by factoring assumed credit losses into the purchase prices we pay for non-Agency RMBS and mortgage loans. In addition, with respect to any particular target asset, we evaluate relative valuation, supply and demand trends, shape of yield curves, prepayment rates, delinquency and default rates, recovery of various sectors and vintage of collateral. We further mitigate credit risk in our mortgage loan portfolio through (1) selecting servicers whose specialties are well matched against the underlying attributes of the mortgage borrowers contained in the loan pools, and (2) an actively managed internal servicer oversight and surveillance program. At times, we enter into credit default swaps or other derivative instruments in an attempt to manage our credit risk. Nevertheless, unanticipated credit losses could adversely affect our operating results.

Item 4. Controls and Procedures

A review and evaluation was performed by our management, including our Chief Executive Officer, or CEO, and Chief Financial Officer, or CFO, of the effectiveness of our disclosure controls and procedures (as such term is defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on that review and evaluation, the CEO and CFO have concluded that our current disclosure controls and procedures, as designed and implemented, were effective. Although our CEO and CFO have determined our disclosure controls and procedures were effective at the end of the period covered by this Quarterly Report on Form 10-Q, a control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that it will detect or uncover failures within the Company to disclose material information otherwise required to be set forth in the reports we submit under the Securities Exchange Act of 1934.

There was no change in our internal control over financial reporting that occurred during the quarter ended June 30, 2013 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 legal claims and/or administrative proceedings that arise in the ordinary course of our business. As of the date of this filing, we are not party to any litigation or legal proceedings or, to the best of our knowledge, any threatened litigation or legal proceedings, which, in our opinion, individually or in the aggregate, would have a material adverse effect on our results of operations or financial condition.

Item 1A. Risk Factors
Other than those set forth in our Quarterly Report on Form 10-Q for the period ended March 31, 2013, or the Q1 Form 10-Q, there have been no material changes to the risk factors set forth under the heading "Item 1A. Risk Factors" of our Annual Report on Form 10-K for the year ended December 31, 2012, or the Form 10-K. The materialization of any risks and uncertainties identified in our Forward Looking Statements contained in this report together with those previously disclosed in the Form 10-K and Q1 Form 10-Q or those that are presently unforeseen could result in significant adverse effects on our financial condition, results of operations, and cash flows. See Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations - Forward Looking Statements" in this Quarterly Report on Form 10-Q.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds
(a)On May 21, 2013, the Company granted 36,335 shares of common stock to its independent directors pursuant to the Company's Restated 2009 Equity Incentive Plan. The estimated fair value of these awards was $11.56 per share, based on the closing price of the Company's common stock on the NYSE on May 21, 2013. These grants were exempt from the registration requirements of the 1933 Act pursuant to Section 4(2) thereof.
(b)None.
(c)On October 5, 2011, the Company's Board of Directors authorized a share repurchase program, which allows the Company to repurchase up to 10,000,000 shares of its common stock. On November 14, 2012, the Board of Directors authorized an increase in the share repurchase program of 15,000,000, for a total of 25,000,000 shares. Shares may be repurchased from time to time through privately negotiated transactions or open market transactions, pursuant to a trading plan in accordance with Rules 10b5-1 and 10b-18 under the Exchange Act or by any combination of such methods. The manner, price, number and timing of share repurchases will be subject to a variety of factors, including market conditions and applicable SEC rules. As of June 30, 2013, 1,000,000 shares had been repurchased by the Company under the program for a total cost of $10.5 million. The following table reflects purchases under the plan during the three months ended June 30, 2013:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans of Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
April 1, 2013 through April 30, 2013	—	$—	—	25,000,000
May 1, 2013 through May 31, 2013	—	—	—	25,000,000
June 1, 2013 through June 30, 2013	1,000,000	10.50	1,000,000	24,000,000
Total	1,000,000	$10.50	1,000,000	24,000,000

Item 3. Defaults Upon Senior Securities
None.

Item 4. Mine Safety Disclosures
None.

Item 5. Other Information
None.

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Item 6. Exhibits

(a) Exhibits

Exhibits - The exhibits listed on the accompanying Index of Exhibits are filed or incorporated by reference as a part of this report. Such Index is incorporated herein by reference.

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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.

			TWO HARBORS INVESTMENT CORP.
Dated:	August 7, 2013	By:	/s/ Thomas Siering
			Thomas Siering
			Chief Executive Officer, President and Director (principal executive officer)
Dated:	August 7, 2013	By:	/s/ Brad Farrell
			Brad Farrell
			Chief Financial Officer and Treasurer (principal accounting and financial officer)

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Exhibit Number	Exhibit Index
1.1	Equity Distribution Agreement among Two Harbors Investment Corp., JMP Securities LLC and Keefe, Bruyette & Woods, Inc. dated May 25, 2012 (incorporated by reference to Exhibit 1.1 to the Registrant's Current Report on Form 8-K filed with the SEC on May 25, 2012).
2.1	Agreement and Plan of Merger, dated as of June 11, 2009, by and among Capitol Acquisition Corp., Two Harbors Investment Corp., Two Harbors Merger Corp. and Pine River Capital Management L.P. (incorporated by reference to Annex A filed with Pre Effective Amendment No. 4 to the Registrant's Registration Statement on Form S-4 (File No. 333-160199) filed with the Securities and Exchange Commission ("SEC") on October 8, 2009 ("Amendment No. 4")).
2.2	Amendment No. 1 to Agreement and Plan of Merger, dated as of August 17, 2009, by and among Capitol Acquisition Corp., Two Harbors Investment Corp., Two Harbors Merger Corp. and Pine River Capital Management L.P. (incorporated by reference to Annex A-2 filed with Amendment No. 4).
2.3	Amendment No. 2 to Agreement and Plan of Merger, dated as of September 20, 2009, by and among Capitol Acquisition Corp., Two Harbors Investment Corp., Two Harbors Merger Corp. and Pine River Capital Management L.P. (incorporated by reference to Annex A-3 filed with Amendment No. 4).
3.1	Articles of Amendment and Restatement of Two Harbors Investment Corp. (incorporated by reference to Exhibit 99.1 to Annex B filed with Amendment No. 4).
3.2	Articles of Amendment to the Articles of Amendment and Restatement of Two Harbors Investment Corp. (incorporated by reference to Exhibit 99.1 to the Registrant's Current Report on Form 8-K filed with the SEC on December 19, 2012).
3.3	Bylaws of Two Harbors Investment Corp. (incorporated by reference to Annex C filed with Amendment No. 4).
4.1	Warrant Agreement between Continental Stock Transfer & Trust Company and Capitol Acquisition Corp. (incorporated by reference to Exhibit 4.1 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2009, filed with the SEC on March 4, 2010 ("2009 Form 10-K")).
4.2	Specimen Common Stock Certificate of Two Harbors Investment Corp. (incorporated by reference to Exhibit 4.2 to Amendment No. 4).
4.3	Specimen Warrant Certificate of Two Harbors Investment Corp. (incorporated by reference to Exhibit 4.3 filed with Pre-Effective Amendment No. 1 to the Registrant's Registration Statement on Form S-4 (File No. 333-160199) filed with the SEC on August 5, 2009).
4.4	Supplement and Amendment to Warrant Agreement between Continental Stock Transfer & Trust Company, Capitol Acquisition Corp. and Two Harbors Investment Corp. (incorporated by reference to Exhibit 4.4 to the Registrant's 2009 Form 10-K).
4.5	Second Amendment to Warrant Agreement between Two Harbors Investment Corp. and Mellon Investors Services LLC (incorporated by reference to Exhibit 99.1 to the Registrant's Current Report on Form 8-K filed with the SEC on December 13, 2010).
10.1*	Restated 2009 Equity Incentive Plan (incorporated by reference to Appendix A to the Registrant's Definitive Proxy Statement filed on March 8, 2013).
10.2*	Form of Restricted Stock Agreement under the Restated 2009 Equity Incentive Plan (incorporated by reference to Exhibit 99.2 to the Registrant's Form S-8 filed on May 28, 2013).
31.1	Certification of the Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. (filed herewith)
31.2	Certification of the Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. (filed herewith)
32.1	Certification of the Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (filed herewith)

32.2	Certification of the Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (filed herewith)
101	Financial statements from the Quarterly Report on Form 10-Q of Two Harbors Investment Corp. for the quarter ended June 30, 2013, filed on August 7, 2013, formatted in XBRL: (i) the Condensed Consolidated Balance Sheets, (ii) the Condensed Consolidated Statements of Comprehensive (Loss) Income, (iii) the Condensed Consolidated Statements of Stockholders' Equity, (iv) the Condensed Consolidated Statements of Cash Flows, and (v) the Notes to the Condensed Consolidated Financial Statements. (filed herewith)

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* Management contract or compensatory agreement.