ALLIED CAPITAL CORP
Form POS 8C
March 22, 2002

As filed with the Securities and Exchange Commission on March 22, 2002

Registration No. 333-67336

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM N-2

REGISTRATION STATEMENT

UNDER
THE SECURITIES ACT OF 1933

o **Pre-Effective Amendment No.**
x **Post-Effective Amendment No. 2**

ALLIED CAPITAL CORPORATION

(Exact Name of Registrant as Specified in Charter)

1919 Pennsylvania Avenue, N.W.

Washington, D.C. 20006-3434
(202) 331-1112
(Address and Telephone Number, including Area Code, of Principal Executive Offices)

William L. Walton, Chairman of the Board and Chief Executive Officer

Allied Capital Corporation
1919 Pennsylvania Avenue, N.W.
Washington, D.C. 20006-3434
(Name and Address of Agent for Service)

Copies of information to:

Steven B. Boehm
Cynthia M. Krus
Sutherland Asbill & Brennan LLP
1275 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-2415

Approximate Date of Proposed Public Offering:

From time to time after the effective date of the Registration Statement.

If any securities being registered on this form will be offered on a delayed or continuous basis in reliance on Rule 415 under the Securities Act of 1933, other than securities offered in connection with a dividend reinvestment plan, check the following box. x

It is proposed that this filing will become effective (check the appropriate box):

x **when declared effective pursuant to Section 8(c).**

PROSPECTUS (Subject to Completion)

Issued , 2002

$300,000,000

Common Stock
Preferred Stock
Debt Securities

Please read this prospectus, and the accompanying prospectus supplement, if any, before investing, and keep it for future reference. It contains important information about the Company.

To learn more about the Company, you may want to look at the Statement of Additional Information dated , 2002 (known as the SAI). For a free copy of the SAI, contact us at:

Allied Capital Corporation
1919 Pennsylvania Avenue, N.W.
Washington, DC 20006
1-888-818-5298

The Company has filed the SAI with the U.S. Securities and Exchange Commission and has incorporated it by reference into this prospectus. The SAI s table of contents appears on page 74 of this prospectus.

The Commission maintains an Internet website (http://www.sec.gov) that contains the SAI, material incorporated by reference and other information about the Company.

Our common stock is traded on the New York Stock Exchange under the symbol ALD. As of , 2002, the last reported sales price on the New York Stock Exchange for the common stock was $.

We may offer, from time to time, up to $300,000,000 of our common stock, preferred stock, or debt securities in one or more offerings. All shares of common stock, preferred stock, and debt securities that are offered under this prospectus are collectively referred to herein as the Securities.

The Securities may be offered at prices and on terms to be described in one or more supplements to this prospectus. In the case of our common stock, the offering price per share less any underwriting commissions or discounts will not be less than the net asset value per share of our common stock at the time we make the offering.

We are an internally managed closed-end management investment company that has elected to be regulated as a business development company under the Investment Company Act of 1940, as amended.

Our investment objective is to achieve current income and capital gains. We seek to achieve our investment objective by investing primarily in private businesses in a variety of industries throughout the United States. No assurances can be given that we will continue to achieve our objective.

You should review the information including the risk of leverage, set forth under Risk Factors on page 8 of this prospectus before investing in the Securities.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus. Any representations to the contrary is a criminal offense.

This prospectus may not be used to consummate sales of Securities unless accompanied by a prospectus supplement.

The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

, 2002

We have not authorized any dealer, salesman or other person to give any information or to make any representation other than those contained or incorporated by reference in this prospectus or any accompanying supplement to this prospectus. You must not rely upon any information or representation not contained or incorporated by reference in this prospectus or the accompanying prospectus supplement as if we had authorized it. This prospectus and any prospectus supplement do not constitute an offer to sell or a solicitation of any offer to buy any security other than the registered securities to which they relate, nor do they constitute an offer to sell or a solicitation of an offer to buy any securities in any jurisdiction to any person to whom it is unlawful to make such an offer or solicitation in such jurisdiction. The information contained in this prospectus and any prospectus supplement is accurate as of the dates on their covers.

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(i)

PROSPECTUS SUMMARY

The following summary contains basic information about this offering. It may not contain all the information that is important to an investor. For a more complete understanding of this offering, we encourage you to read this entire document and the documents to which we have referred.

In this prospectus or any accompanying prospectus supplement, unless otherwise indicated, the Company , ACC , we , us or our refer to Allied Capital Corporation and its subsidiaries.

THE COMPANY *(Page 13)*

We are a business development company and provide long-term debt and equity investment capital to support the expansion of growing businesses in a variety of industries in diverse geographic locations throughout the United States. We have been investing in growing businesses for over 40 years and have financed thousands of companies nationwide. Our investment and lending activity is focused in two areas:

- private finance, and
- commercial real estate finance, or the investment in non-investment grade commercial mortgage-backed securities (CMBS).

Our investment portfolio includes:

- long-term unsecured loans with equity features,
- equity investments in growing companies, which may or may not constitute a controlling equity interest,
- non-investment grade commercial mortgage-backed securities, and
- commercial mortgage loans.

We identify loans and investments through our numerous relationships with:

- mezzanine and private equity investors,
- investment banks, and
- other intermediaries, including professional services firms.

In order to increase our sourcing and origination activities, we have two regional offices in New York and Chicago. We centralize our credit approval process and service our loans through an experienced staff of professionals at our headquarters in Washington, DC.

We have an advantageous tax structure, as compared to operating companies, that allows for the pass-through of income to our shareholders through dividends without the imposition of a corporate level of taxation. See Tax Status.

We are an internally managed diversified closed-end management investment company that has elected to be regulated as a business development company (BDC) under the Investment Company Act of 1940, as amended (1940 Act). Our investment objective is to achieve current income and capital gains. We seek to achieve our investment objective by investing in growing businesses in a variety of industries throughout the United States. As a BDC, we are required to meet regulatory tests, the most significant relating to our investments and borrowings. A BDC is required to invest at least 70% of its assets in private or thinly traded public, U.S.-based companies. A BDC must maintain a

coverage ratio of assets to senior securities of at least 200%. See Business Certain Government Regulations.

We are quoted on the New York Stock Exchange and trade under the symbol ALD.

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THE OFFERING *(Page 72)*

We may offer, from time to time, up to $300,000,000 of our Securities, on terms to be determined at the time of offering.

Securities may be offered at prices and on terms described in one or more supplements to this prospectus. In the case of the offering of our common stock, the offering price per share less any underwriting commission or discount will not be less than the net asset value per share of our common stock at the time we make the offering.

Our Securities may be offered directly to one or more purchasers, through agents designated from time to time by us, or to or through underwriters or dealers. The supplement to this prospectus relating to the offering will identify any agents or underwriters involved in the sale of our Securities, and will set forth any applicable purchase price, fee and commission or discount arrangement between our agents and us or among our underwriters or the basis upon which such amount may be calculated.

We may not sell Securities without delivering a prospectus supplement describing the method and terms of the offering of our Securities.

USE OF PROCEEDS *(Page 13)*

Unless otherwise specified in the prospectus supplement accompanying this prospectus, we intend to use the net proceeds from selling Securities for general corporate purposes, which may include investments in growing businesses or CMBS, repayment of indebtedness, acquisitions and other general corporate purposes.

DISTRIBUTIONS *(Page 14)*

We pay quarterly dividends to holders of our common stock. The amount of our quarterly dividends is determined by the Board of Directors. Other types of Securities will likely pay distributions in accordance with their terms.

DIVIDEND REINVESTMENT PLAN *(Page 67)*

We have adopted an opt out dividend reinvestment plan (DRIP plan) for our common stockholders. Under the DRIP plan, if your shares of common stock are registered in your name, your dividends will be *automatically* reinvested in additional shares of our common stock unless you opt out of the DRIP plan. After May 1, 2002, our DRIP plan will convert to an opt-in plan.

PRINCIPAL RISK FACTORS *(Page 8)*

Investment in Securities involves certain risks relating to our structure and our investment objective that you should consider before purchasing Securities.

As a BDC, our consolidated portfolio includes securities primarily issued by privately held companies. These investments may involve a high degree of business and financial risk, and they are generally illiquid. A large number of entities and individuals compete for the same kind of investment opportunities as we do.

We borrow funds to make investments in private businesses. As a result, we are exposed to the risks of leverage, which may be considered a speculative investment technique. Borrowings, also known as leverage, magnify the potential for gain and loss on amounts invested and, therefore increase the risks associated with investing in our securities.

Also, we are subject to certain risks associated with investing in non-investment grade CMBS, valuing our portfolio, changing interest rates, accessing additional capital, fluctuating quarterly results,

and operating in a regulated environment. In addition, the loss of pass-through tax treatment could have a material adverse effect on our total return, if any.

CERTAIN ANTI-TAKEOVER

PROVISIONS *(Page 69)*

Our charter and bylaws, as well as certain statutory and regulatory requirements, contain certain provisions that may have the effect of discouraging a third party from making an acquisition proposal for the Company. These anti-takeover provisions may inhibit a change in control in circumstances that could give the holders of our common stock the opportunity to realize a premium over the market price for our common stock.

FEES AND EXPENSES

This table describes the various costs and expenses that an investor in our Securities will bear directly or indirectly.

Shareholder Transaction Expenses	
Sales load (as a percentage of offering price)(1)	%
Dividend reinvestment plan fees(2)	None
Annual Expenses (as a percentage of consolidated net assets attributable to common stock)(3)	
Operating expenses(4)	3.3%
Interest payments on borrowed funds(5)	4.8%
Total annual expenses(6)	8.1%

(1) In the event that the Securities to which this prospectus relates are sold to or through underwriters, a corresponding prospectus supplement will disclose the applicable sales load.

(2) The expenses of the Company s DRIP plan are included in Operating expenses. The Company has no cash purchase plan. The participants in the DRIP plan will bear a pro rata share of brokerage commissions incurred with respect to open market purchases, if any. See Dividend Reinvestment Plan.

(3) Consolidated net assets attributable to common stock equals net assets (*i.e.*, total assets less total liabilities and preferred stock) at December 31, 2001.

(4) Operating expenses represent the operating expenses of the Company for the year ended December 31, 2001 excluding interest on indebtedness. This percentage for the year ended December 31, 2000 was 3.4%.

(5) The Interest payments on borrowed funds represents the interest expenses of the Company for the year ended December 31, 2001. The Company had outstanding borrowings of $1,020.8 million at December 31, 2001. This percentage for the year ended December 31, 2000 was 5.6%. See Risk Factors.

(6) Total annual expenses as a percentage of consolidated net assets attributable to common stock are higher than the total annual expenses percentage would be for a company that is not leveraged. The Company borrows money to leverage its net assets and increase its total assets. The Securities and Exchange Commission requires that Total annual expenses percentage be calculated as a percentage of *net* assets, rather than the total assets, including assets that have been funded with borrowed monies. If the Total annual expenses percentage were calculated instead as a percentage of consolidated total assets, Total annual expenses for the Company would be 4.5% of consolidated total assets.

Example

The following example, required by the Commission, demonstrates the projected dollar amount of total cumulative expenses that would be incurred over various periods with respect to a hypothetical investment in the Company. In calculating the following expense amounts, we assumed we would have no additional leverage and that our operating expenses would remain at the levels set forth in the table above. In the event that shares to which this prospectus relates are sold to or through underwriters, a corresponding prospectus supplement will restate this example to reflect the applicable sales load.

	1 Year	3 Years	5 Years	10 Years
You would pay the following expenses on a $1,000 investment, assuming a 5.0% annual return	$82	$247	$413	$837

Although the example assumes (as required by the Commission) a 5.0% annual return, our performance will vary and may result in a return of greater or less than 5.0%. In addition, while the example assumes reinvestment of all dividends and distributions at net asset value, participants in the DRIP plan may receive shares of common stock that we issue at or above net asset value or are purchased by the administrator of the DRIP plan, at the market price in effect at the time, which may be higher than, at, or below net asset value. See Dividend Reinvestment Plan.

The example should not be considered a representation of future expenses, and the actual expenses may be greater or less than those shown.

SELECTED CONSOLIDATED FINANCIAL DATA

You should read the consolidated financial information below with the Consolidated Financial Statements and Notes thereto included in this prospectus. Financial information for the years ended December 31, 2001, 2000, 1999, 1998 and 1997 has been derived from audited financial statements. **See Management s Discussion and Analysis of Financial Condition and Results of Operations on page 15 for more information.**

(In thousands, except per share data)	Year Ended December 31, 2001	2000	1999	1998	1997
Operating Data:					
Interest and related portfolio income:					
Interest and dividends	$240,464	$182,307	$121,112	$80,281	$86,882
Premiums from loan dispositions	2,504	16,138	14,284	5,949	7,277
Post-merger gain on securitization of commercial mortgage loans				14,812	
Fees and other income	46,142	13,144	5,744	5,696	3,246
Total interest and related portfolio income	289,110	211,589	141,140	106,738	97,405
Expenses:					
Interest	65,104	57,412	34,860	20,694	26,952
Employee	29,656	26,025	22,889	18,878	10,258
Administrative	15,299	15,435	12,350	11,921	8,970
Merger					5,159

Total operating expenses	110,059	98,872	70,099	51,493	51,339
Net operating income before net realized and unrealized gains	179,051	112,717	71,041	55,245	46,066
Net realized and unrealized gains:					
Net realized gains	661	15,523	25,391	22,541	10,704
Net unrealized gains	20,603	14,861	2,138	1,079	7,209
Total net realized and unrealized gains	21,264	30,384	27,529	23,620	17,913

Income before minority interests and income taxes
200,315 143,101 98,570 78,865 63,979
Minority interests
1,231
Income tax benefit (expense)
412 (787) (1,444)

Net increase in net assets resulting from operations
$200,727 $143,101 $98,570 $78,078 $61,304

Per Share:

Diluted net operating income per common share(1)
$1.92 $1.53 $1.18 $1.06 $1.04
Diluted earnings per common share
$2.16 $1.94 $1.64 $1.50 $1.24
Dividends per common share(2)
$2.01 $1.82 $1.60 $1.43 $1.71
Weighted average common shares outstanding diluted(3)
93,003 73,472 60,044 51,974 49,251

(in thousands, except per share data)	At December 31,				
	2001	2000	1999	1998	1997

Balance Sheet Data:

Portfolio at value
$2,329,590 $1,788,001 $1,228,497 $807,119 $703,331
Portfolio at cost
2,286,602 1,765,895 1,222,901 803,479 697,030

Total assets	2,460,713	1,853,817	1,290,038	856,079	807,775
Total debt outstanding(4)	1,020,806	786,648	592,850	334,350	347,663
Preferred stock issued to SBA(4)	7,000	7,000	7,000	7,000	7,000
Shareholders equity	1,352,123	1,029,692	667,513	491,358	420,060
Shareholders equity per common share (NAV)	$13.57	$12.11	$10.20	$8.79	$8.07
Common shares outstanding at period end(3)	99,607	85,057	65,414	55,919	52,047

	Year Ended December 31,				
	2001	**2000**	**1999**	**1998**	**1997**
Other Data:					
Investments funded	$680,329	$901,545	$751,871	$524,530	$364,942
Repayments	74,461	111,031	139,561	138,081	233,005
Sales	129,980	280,244	198,368	81,013	53,912
Realized gains	10,107	28,604	31,536	25,757	15,804
Realized losses	(9,446)	(13,081)	(6,145)	(3,216)	(5,100)

(1) Diluted net operating income per common share for the year ended December 31, 1997 excludes merger-related expenses.

(2) Distributions are based on taxable income, which differs from income for financial reporting purposes. Dividends for 1997 exclude certain merger-related dividends of $0.51 per common share.

(3) Excludes 234,977, 516,779 and 810,456 common shares held in the deferred compensation trust at or for the years ended December 31, 2000, 1999, and 1998, respectively.

(4) See Senior Securities on page 30 for more information regarding the Company s level of indebtedness.

	2001				2000			
(in thousands, except per share data)	**Qtr 4**	**Qtr 3**	**Qtr 2**	**Qtr 1**	**Qtr 4**	**Qtr 3**	**Qtr 2**	**Qtr 1**
	(unaudited)				(unaudited)			
Quarterly Data:								
Total interest and related portfolio income	$82,666	$72,634	$68,739	$65,071	$61,735	$55,992	$49,965	$43,897
Net operating income before net realized and unrealized gains	53,016	44,189	42,118	39,728	34,725	30,719	24,700	22,573
Net increase in net assets resulting from operations	42,890	59,703	46,106	52,028	42,281	36,449	34,790	29,581
Diluted net operating income per share	$0.53	$0.47	$0.46	$0.46	$0.43	$0.40	$0.35	$0.34
Diluted earnings per common share	0.43	0.63	0.51	0.60	0.52	0.48	0.50	0.45
Dividends declared per common share	0.51	0.51	0.50	0.49	0.46	0.46	0.45	0.45
Net asset value per common share(1)	13.57	13.42	12.79	12.26	12.11	11.56	10.96	10.44

(1) We determine net asset value per common share as of the last day of the quarter. The net asset values shown are based on outstanding shares at the end of each period, excluding common shares held in the Company s deferred compensation trust.

WHERE YOU CAN FIND

ADDITIONAL INFORMATION

We have filed with the Commission a registration statement on Form N-2 together with all amendments and related exhibits under the Securities Act of 1933, as amended (the Securities Act). The registration statement contains additional information about us and the registered securities being offered by this prospectus. You may inspect the registration statement and the exhibits without charge at the Securities and Exchange Commission at 450 Fifth Street, NW, Washington, DC 20549. You may obtain copies from the Commission at prescribed rates.

We file annual, quarterly and current reports, proxy statements and other information with the Commission. You can inspect, without charge, at the public reference facilities of the Commission at 450 Fifth Street, NW, Washington, DC 20549. The Commission also maintains a web site at *http://www.sec.gov* that contains reports, proxy statements and other information regarding public companies, including the Company. You can also obtain copies of these materials from the public reference section of the Commission at 450 Fifth Street, NW, Washington, DC 20549, at prescribed rates. Please call the Commission at 1-800-SEC-0330 for further information on the public reference room. Copies may also be obtained, after paying a duplicating fee, by electronic request to publicinfo@sec.gov or by written request to Public Reference Section, Washington, DC 20549-0102. You can also inspect reports and other information we file at the offices of the New York Stock Exchange, and you are able to inspect those at 20 Broad Street, New York, NY 10005.

RISK FACTORS

Investing in the Company involves a number of significant risks and other factors relating to the structure and investment objective of the Company. As a result, there can be no assurance that the Company will achieve its investment objective. In addition to the information contained in this prospectus, you should consider carefully the following information before making investments in the Securities.

Investing in Private Companies Involves a High Degree of Risk. Our portfolio consists primarily of long-term loans to and investments in private companies. Investments in private businesses involve a high degree of business and financial risk, which can result in substantial losses and accordingly should be considered speculative. There is generally no publicly available information about the companies in which we invest, and we rely significantly on the diligence of our employees and agents to obtain information in connection with our investment decisions. In addition, some smaller businesses have narrower product lines and market shares than their competition, and may be more vulnerable to customer preferences, market conditions or economic downturns, which may adversely affect the return on, or the recovery of, our investment in such businesses.

Our Portfolio of Investments is Illiquid. We acquire most of our investments directly from the issuer in privately negotiated transactions. The majority of the investments in our portfolio are subject to restrictions on resale or otherwise have no established trading market. The illiquidity of our investments may adversely affect our ability to dispose of loans and securities at times when it may be advantageous for us to liquidate such investments. In addition, if we were required to liquidate some or all of the investments in the portfolio, the proceeds of such liquidation would be significantly less than the current value of such investments.

Our Portfolio Investments Are Recorded at Fair Value As Determined in Good Faith by the Board of Directors in Absence of Readily Ascertainable Public Market Values. Pursuant to the requirements of the Investment Company Act of 1940 (1940 Act), the Company values its securities at fair value as determined in good faith by the Company s Board of Directors on a quarterly basis. Since there is typically no ready market for the investments in our portfolio, our Board of Directors estimates the fair value of these investments pursuant to a written valuation policy and a consistently applied valuation process. Unlike banks, we are not permitted to provide a general reserve for anticipated loan losses; we are instead required by the 1940 Act to specifically value each individual investment and record an unrealized loss for an asset that we believe has become impaired. Without a readily ascertainable market value, the estimated value of our portfolio of investments may differ significantly from the values that would be placed on the portfolio if there existed a ready market for the investments. We adjust quarterly the valuation of our portfolio to reflect the Board of Directors estimate of the current fair value of each investment in our portfolio. Any changes in estimated fair value are recorded in the Company s statement of operations as Net unrealized gains (losses).

Economic Recessions or Downturns Could Impair Our Portfolio Companies and Harm Our Operating Results. Although our investment strategy focuses on investment in companies in less cyclical industries, some of the companies in which we have made or will make investments may be susceptible to economic slowdowns or recessions. An economic slowdown may affect the ability of a company to engage in a liquidity event or repay our loans. These conditions could lead to financial losses in our portfolio and a decrease in our revenues, net income and assets.

Our business of making private equity investments and positioning them for liquidity events also may be affected by current and future market conditions. The absence of a robust senior lending environment may slow the amount of private equity investment activity generally. As a result, the pace of our investment activity may slow. In addition, significant changes in the capital markets could have an effect on the valuations of private companies and on the potential for liquidity events involving such companies. This could affect the amount and timing of gains realized on our investments.

Our Borrowers May Default on Their Payments. We make unsecured, subordinated loans and invest in equity securities, which may involve a higher degree of repayment risk. We primarily invest in companies that may have limited financial resources and that may be unable to obtain financing from traditional sources. Numerous factors may affect a borrower s ability to repay its loan, including the failure to meet its business plan, a downturn in its industry or negative economic conditions. Deterioration in a borrower s financial condition and prospects may be accompanied by deterioration in any related collateral.

Our Private Finance Investments May Not Produce Current Returns or Capital Gains. Private finance investments are typically structured as debt securities with a relatively high fixed rate of interest and with equity features such as conversion rights, warrants or options. As a result, private finance investments are generally structured to generate interest income from the time they are made, and may also produce a realized gain from an accompanying equity feature. We cannot be sure that our portfolio will generate a current return or capital gains.

Our Financial Results Could Be Negatively Affected If BLX Fails to Perform As Expected. Business Loan Express, Inc. (BLX) is our largest portfolio investment. Our financial results could be negatively affected if BLX, as a portfolio company, fails to perform as expected or if regulations related to the SBA 7(a) Guaranteed Loan Program change. At December 31, 2001, the investment totaled $227.4 million, or 9% of total assets. In addition, as controlling shareholder of BLX, we have provided an unconditional guaranty to BLX s credit facility lenders in an amount equal to 50% of BLX s total obligations on its $124.0 million unsecured revolving credit facility. The amount we have guaranteed at December 31, 2001 was $51.4 million. This guaranty can only be called in the event of a default by BLX.

Investments in Non-Investment Grade Commercial Mortgage-Backed Securities May Be Illiquid and May Have a Higher Risk of Default. The commercial mortgage-backed securities (CMBS) in which we invest are non-investment grade, which means that nationally recognized statistical rating organizations rate them below the top four investment-grade rating categories (i.e., AAA through BBB), and are sometimes referred to as junk bonds. The non-investment grade CMBS tend to be less liquid, may have a higher risk of default and may be more difficult to value. Non-investment grade securities usually provide a higher yield than do investment-grade bonds, but with the higher return comes greater risk. Non-investment grade securities are considered speculative, and their capacity to pay principal and interest in accordance with the terms of their issue is not ensured.

We May Not Borrow Money Unless We Maintain Asset Coverage for Indebtedness of At Least 200% Which May Affect Returns to Shareholders. We must maintain asset coverage for a class of senior security representing indebtedness of at least 200%. Our ability to achieve our investment objective may depend in part on our continued ability to

maintain a leveraged capital structure by borrowing from banks or other lenders on favorable terms. There can be no assurance that we will be able to maintain such leverage. If asset coverage declines to less than 200%, we may be required to sell a portion of our investments when it is disadvantageous to do so. As of December 31, 2001, our asset coverage for senior indebtedness was 245%.

We Borrow Money Which Magnifies the Potential for Gain or Loss on Amounts Invested and May Increase the Risk of Investing in Our Company. Although we maintain a conservatively leveraged capital structure, borrowings, also known as leverage, magnify the potential for gain or loss on amounts invested and, therefore, increase the risks associated with investing in our securities. We borrow from, and issue senior debt securities to, banks, insurance companies and other lenders. Lenders of these senior securities have fixed dollar claims on our consolidated assets that are superior to the claims of our common shareholders. If the value of our consolidated assets increases, then leveraging would cause the net asset value attributable to the Company s common stock to increase more sharply than it would have had we not leveraged. Conversely, if the value of our consolidated assets decreases, leveraging would cause net asset value to decline more sharply than it otherwise would have had we not leveraged. Similarly, any increase in our consolidated income in excess of consolidated interest payable on the borrowed funds would cause our net income to increase more than it would without the leverage, while any decrease in our consolidated income would cause net income to decline more sharply than it would have had we not borrowed. Such a decline could negatively affect our ability to make common stock dividend payments. Leverage is generally considered a speculative investment technique.

At December 31, 2001, the Company had $1,020.8 million of outstanding indebtedness, bearing a weighted annual interest cost of 7.0%. In order for us to cover these annual interest payments on indebtedness, we must achieve annual returns on our assets of at least 2.9%.

Illustration. The following table illustrates the effect of leverage on returns from an investment in our common stock assuming various annual returns, net of expenses. The calculations in the table below are hypothetical and actual returns may be higher or lower than those appearing below. The calculation assumes (i) $2,460.7 million in total assets, (ii) an average cost of funds of 7.0%, (iii) $1,020.8 million in debt outstanding and (iv) $1,352.1 million of shareholders equity.

Assumed Return on the Company s Portfolio

(net of expenses)

	-20%	-10%	-5%	0%	5%	10%	20%
Corresponding return to shareholder	-41.7%	-23.5%	-14.4%	-5.3%	3.8%	12.9%	31.1%

Changes in Interest Rates May Affect Our Cost of Capital and Net Operating Income. Because we borrow money to make investments, our net operating income is dependent upon the difference between the rate at which we borrow funds and the rate at which we invest these funds. As a result, there can be no assurance that a significant change in market interest rates will not have a material adverse effect on our interest income. In periods of sharply rising interest rates, our cost of funds would increase, which would reduce our net operating income before net realized and unrealized gains. We use a

combination of long-term and short-term borrowings and equity capital to finance our investing activities. The Company utilizes its short-term credit facilities as a means to bridge to long-term financing. Our long-term fixed-rate investments are financed primarily with long-term fixed-rate debt and equity. We may use interest rate risk management techniques in an effort to limit our exposure to interest rate fluctuations. Such techniques may include various interest rate hedging activities to the extent permitted by the 1940 Act. The Company has analyzed the potential impact of changes in interest rates on interest income net of interest expense. Assuming that the balance sheet were to remain constant and no actions were taken to alter the existing interest rate sensitivity, a hypothetical immediate 1% change in interest rates would have affected NIA by less than 1% over a six month horizon. Although management believes that this measure is indicative of the Company s sensitivity to interest rate changes, it does not adjust for potential changes in credit quality, size and composition of the assets on the balance sheet and other business developments that could affect NIA. Accordingly, no assurances can be given that actual results would not differ materially from the potential outcome simulated by this estimate.

Because We Must Distribute Income, We Will Continue to Need Additional Capital to Grow. We will continue to need capital to fund incremental growth in our investments. Historically, we have borrowed from financial institutions and have issued equity securities. A reduction in the availability of new capital could limit our ability to grow. We must distribute at least 90% of our taxable ordinary income, which excludes net realized long-term capital gains, to our stockholders to maintain our regulated investment company (RIC) status. As a result, such earnings will not be available to fund investment originations. We expect to continue to borrow from financial institutions and sell additional equity securities. If we fail to obtain funds from such sources or from other sources to fund our investments, it could limit our ability to grow, which could have a material adverse effect on the value of the Company s common stock. In addition, as a BDC, we are generally required to maintain a ratio of at least 200% of total assets to total borrowings, which may restrict our ability to borrow in certain circumstances.

Loss of Pass-Through Tax Treatment Would Substantially Reduce Net Assets and Income Available for Dividends. We have operated the Company so as to qualify to be taxed as a RIC under Subchapter M of the Internal Revenue Code of 1986, as amended (Code). If we meet source of income, diversification and distribution requirements, the Company qualifies for effective pass-through tax treatment. The Company would cease to qualify for such pass-through tax treatment if it were unable to comply with these requirements. We also could be subject to a 4% excise tax and/or corporate level income tax if we fail to make required distributions as a RIC. If the Company ceased to qualify as a RIC, the Company would become subject to federal income tax, which would substantially reduce our net assets and the amount of income available for distribution to our shareholders.

We Operate in a Competitive Market for Investment Opportunities. We compete for investments with many other companies and individuals, some of whom have greater resources than we do. Increased competition would make it more difficult for us to purchase or originate investments at attractive prices. As a result of this competition, sometimes we may be precluded from making otherwise attractive investments.

Changes in the Law or Regulations That Govern the Company Could Have a Material Impact on the Company or Our Operations. We are regulated by the Securities and Exchange Commission and the SBA. In addition, changes in the laws or regulations

that govern BDCs, RICs, real estate investment trusts (REITs), and small business investment companies (SBICs) may significantly affect our business. Any change in the law or regulations that govern our business could have a material impact on the Company or its operations. Laws and regulations may be changed from time to time, and the interpretations of the relevant laws and regulations also are subject to change.

Results May Fluctuate and May Not Be Indicative of Future Performance. The Company s operating results will fluctuate and, therefore, you should not rely on current period results to be indicative of the Company s performance in future reporting periods. Factors that could cause operating results to fluctuate include, among others, variations in the investment origination volume and fee income earned, variation in timing of prepayments, variations in and the timing of the recognition of realized and unrealized gains or losses, the degree to which we encounter competition in our markets and general economic conditions.

Disclosure Regarding Forward-Looking Statements

Information contained or incorporated by reference in this prospectus, and the accompanying prospectus supplement, if any, may contain forward-looking statements which can be identified by the use of forward-looking terminology such as may, will, expect, intend, anticipate, estimate or continue or th thereof or other variations or similar words or phrases. The matters described in Risk Factors and certain other factors noted throughout this prospectus, and the accompanying prospectus supplement, if any, and in any exhibits to the registration statement of which this prospectus, and the accompanying prospectus supplement, if any, is a part, constitute cautionary statements identifying important factors with respect to any such forward-looking statements, including certain risks and uncertainties, that could cause actual results to differ materially from those in such forward-looking statements.

THE COMPANY

Allied Capital is principally engaged in providing long-term debt and equity investment capital to support the expansion of growing businesses. The Company is organized in the State of Maryland and is an internally managed closed-end management investment company that has elected to be regulated as a business development company (as defined above, a BDC) under the 1940 Act.

Our executive offices are located at 1919 Pennsylvania Avenue, NW, Washington, DC 20006 and our telephone number is (202) 331-1112. In addition, we have two regional offices in New York and Chicago. We also have an office in Frankfurt, Germany.

USE OF PROCEEDS

Unless otherwise specified in the prospectus supplement accompanying this prospectus, we intend to use the net proceeds from selling Securities for general corporate purposes, which may include investment in growing businesses or commercial mortgage-backed securities, repayment of indebtedness, acquisitions and other general corporate purposes.

We raise equity from time to time using a shelf registration statement. We raise new equity when we have a clear use of proceeds for attractive investment opportunities. Historically, this process has enabled us to raise equity on an accretive basis for existing shareholders of our common stock.

We anticipate that substantially all of the net proceeds of any offering of Securities will be used, as described above, within six months, but in no event longer than two years. Pending investment, we intend to invest the net proceeds of any offering of Securities in time deposits, income-producing securities with maturities of three months or less that are issued or guaranteed by the federal government or an agency of the federal government, and high quality debt securities maturing in one year or less from the time of investment. Our ability to achieve our investment objective may be limited to the extent that the net proceeds of any offering, pending full investment, are held in time deposits and other short-term instruments.

PRICE RANGE OF COMMON STOCK AND DISTRIBUTIONS

Our common stock is traded on the New York Stock Exchange under the symbol ALD. The following table lists the high and low closing sales prices for the Company s common stock. On , 2002, the last reported closing sale price of the common stock was $ per share.

	Closing Sale Price(1)	
	High	Low
Year ended December 31, 2000		
First Quarter	$19.69	$16.06
Second Quarter	18.69	16.56
Third Quarter	21.13	17.44
Fourth Quarter	21.38	18.50
Year ending December 31, 2001		
First Quarter	$24.44	$20.13
Second Quarter	25.40	19.57
Third Quarter	24.83	21.50
Fourth Quarter	26.00	21.57
Year ending December 31, 2002		
First Quarter (through , 2002)		

(1) Prior to June 6, 2001, the Company s common stock was traded on the Nasdaq National Market under the symbol ALLC. The closing sale prices listed are as reflected on the respective exchanges for the periods presented.

Our common stock continues to trade in excess of net asset value. There can be no assurance, however, that we will maintain a premium to net asset value.

We pay quarterly dividends to stockholders of our common stock. The amount of our quarterly dividends is determined by the Board of Directors. The Company s Board has established a dividend policy to review the dividend rate quarterly and to adjust the quarterly dividend rate as the Company s earnings momentum builds. See Management s Discussion and Analysis of Financial Condition and Results of Operations Equity Capital and Dividends and Tax Status. We cannot assure that we will achieve investment results or maintain a tax status that will permit any particular level of dividend payment.

Our credit facilities limit our ability to declare dividends if we default under certain provisions.

We have adopted an opt out dividend reinvestment plan (DRIP plan) for our common stockholders. Under the DRIP plan, if your shares of our common stock are registered in your name, your dividends will be *automatically* reinvested in additional shares of common stock unless you opt out of the DRIP plan. Beginning on May 1, 2002, our DRIP plan will convert to an opt-in plan. Thereafter, any new shares registered in your name to a new account will automatically receive cash dividends, unless you specifically opt in to the DRIP plan to reinvest your dividends and receive additional shares of common stock.

MANAGEMENT S DISCUSSION AND ANALYSIS

OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The information contained in this section should be read in conjunction with the Selected Consolidated Financial Data and the Company s Consolidated Financial Statements and Notes thereto.

OVERVIEW

The Company is a business development company (BDC) that provides long-term debt and equity investment capital to support the expansion of growing businesses in a variety of industries and in diverse geographic locations. Our lending and investment activity is focused in private finance and commercial real estate finance, or the investment in non-investment grade commercial mortgage-backed securities (CMBS).

PORTFOLIO COMPOSITION

The Company s earnings depend primarily on the level of interest and related portfolio income and net realized and unrealized gains earned on the Company s investment portfolio after deducting interest paid on borrowed capital and operating expenses. Interest income results from the stated interest rate earned on a loan and the amortization of loan origination points and discounts. The level of interest income is directly related to the balance of the interest-bearing investment portfolio multiplied by the weighted average yield. The Company s ability to generate interest income is dependent on economic, regulatory and competitive factors that influence new investment activity, and the Company s ability to secure debt and equity capital for its investment activities.

PORTFOLIO AND INVESTMENT ACTIVITY

Total portfolio investment activity and yields as of and for the years ended December 31, 2001, 2000 and 1999 were as follows:

($ in millions)	2001	2000	1999
Portfolio at value	$2,329.6	$1,788.0	$1,228.5
Investments funded	$680.3	$901.5	$751.9
Change in accrued or reinvested interest and dividends	$51.6	$32.2	$12.8
Repayments	$74.5	$111.0	$139.6
Sales	$130.0	$280.2	$198.4
Yield	14.3%	14.1%	13.0%

Private Finance

The private finance portfolio, investment activity and yields as of and for the years ended December 31, 2001, 2000 and 1999 were as follows:

($ in millions)	2001	2000	1999
Portfolio at value:			
Loans and debt securities	$1,107.9	$966.3	$559.7
Equity interests	487.2	316.2	87.3
Total portfolio	$1,595.1	$1,282.5	$647.0
Investments funded	$287.7	$600.9	$346.7
Change in accrued or reinvested interest and dividends	$48.9	$31.8	$10.1
Repayments	$43.8	$75.7	$83.2
Yield	14.8%	14.6%	14.2%

Private finance new investment activity across the industry was slow during 2001, largely due to a lack of available senior debt capital. Since equity-focused buyout firms generally need both senior and subordinated debt to leverage new private equity investments, merger and acquisition activity was significantly less than activity in previous years. As a result, the Company s investment activity for 2001 was also at a slower pace.

Investments funded during 2001 consisted of a variety of types of private finance transactions, including $117.3 million in new mezzanine investments, $74.6 million in control buyout transactions, $88.9 million of growth, acquisition and other financings, and $6.9 million to fund existing investment commitments. Investments funded during 2000 and 1999 consisted of $480.0 million and $334.6 million in new mezzanine investments, $95.2 million and $0 in control buyout transactions, $15.6 million and $10.3 million of growth, acquisition and other financings, and $10.1 million and $1.8 million to fund existing investment commitments, respectively. The Company funds new investments using cash, through the issuance of its common equity, the reinvestment of previously accrued interest and dividends in debt or equity securities, or the current reinvestment of interest and dividend income through the receipt of a debt or equity security. From time to time the Company may opt to reinvest accrued interest receivable in a new debt or equity security, in lieu of receiving such interest in cash and providing a subsequent growth investment.

Key investment characteristics for new mezzanine investments were as follows:

	2001	2000	1999
Number of investments	13	34	27
Average investment size (millions)	$9.0	$14.0	$12.4
Weighted average yield	15.8%	14.7%	13.6%
Average portfolio company revenue (millions)	$87.0	$153.5	$86.9
Average portfolio company years in business	44	36	29

The average investment and portfolio company characteristics above are computed using simple averages based upon underwriting data for investment activity for that year. As a result, any one investment may have had individual investment characteristics that may vary significantly from the stated simple average. In addition, average investment characteristics may vary from year to year.

The weighted average yield on new mezzanine investments will fluctuate over time depending on the equity kicker or warrants received with each debt financing. The yield on new mezzanine investments is computed as the (a) annual stated interest rate earned on new interest-bearing investments divided by (b) total new mezzanine investments. Private finance mezzanine investments are generally structured such that equity kickers may provide an additional future investment return of up to 10%.

In addition to private finance mezzanine investment activities, the Company may acquire more than 50% of the common stock of a company in a control buyout transaction. Control investments are generally structured such that the Company earns a current return through a combination of interest income on senior loans and subordinated debt, dividends on preferred and common stock, and management or transaction services fees to compensate the Company for the management assistance that is provided to the controlled portfolio company. The Company s most significant investments acquired through control buyout transactions at December 31, 2001 were SunSource Inc. and Business Loan Express, Inc.

During 2001, the Company acquired 93.2% of the common equity of SunSource Inc. for $71.5 million in cash. Subsequently, SunSource completed the sale of its STS business unit and distributed $16.5 million in cash to the Company, reducing the Company s common stock cost basis to $57.2 million at December 31, 2001. As part of the STS sale, the Company invested $3.2 million in the new STS. During the third quarter of 2001, the Company received fees from SunSource of $2.8 million related to transaction assistance for the SunSource sale and STS sale, and $1.6 million for the syndication of SunSource s senior credit facilities. In addition, the Company realized a gain of $2.5 million from the sale of warrants prior to the buyout transaction. SunSource is a leading manufacturer of key making equipment and distributor of key blanks, fasteners, signage and other small hardware components to hardware retailers. SunSource s primary operations are located in Cincinnati, Ohio.

On December 31, 2000, the Company acquired 94.9% of BLC Financial Services, Inc. in a going private buyout transaction for $95.2 million. The Company issued approximately 4.1 million shares, or $86.1 million of new equity, and paid $9.1 million in cash to acquire BLC, which thereafter changed its name to Business Loan Express, Inc. (BLX).

As part of the transaction, the Company recapitalized its Allied Capital Express operations as an independently managed private portfolio company and merged it into BLX. The Company contributed certain assets, including its online rules-based underwriting technology and fixed assets, and transferred 37 employees to the private portfolio company. Upon completion of the transaction, the Company s investment in BLX totaled $204.1 million and consisted of $74.5 million of subordinated debt, $25.1 million of preferred stock, and $104.5 million of common stock, including capitalized costs.

At December 31, 2001, BLX had a 3-year $124.0 million revolving credit facility (BLX Credit Facility). As the controlling shareholder of BLX, the Company has provided an unconditional guaranty to the BLX Credit Facility lenders in an amount of up to 50% of the total obligations (consisting of principal, accrued interest and other fees) of BLX on the line of credit. The amount guaranteed by the Company at December 31, 2001 was $51.4 million. This guaranty can be called by the lenders only in the event of a default by BLX. BLX was in compliance with the terms of the BLX Credit Facility at December 31, 2001.

BLX is the nation s second largest government guaranteed lender utilizing the Small Business Administration s 7(a) Guaranteed Loan Program. BLX has offices in 32 cities and is headquartered in New York, NY.

During the second quarter of 2000, the Company began an initiative to invest in and strategically partner with select private equity funds focused on venture capital investments. The strategy for these fund investments is to provide solid investment returns and build strategic relationships with the fund managers and their portfolio companies. The Company believes that it will have opportunities to co-invest with the funds as well as finance their portfolio companies as they mature.

The Company believes that the fund investment strategy is an effective means of participating in private equity investing through a diverse pooled investment portfolio. The fund concept allows the Company to participate in a pooled investment return without exposure to the risk of any single investment. Since the beginning of 2000, the Company has committed a total of $44.5 million to eight private equity funds. The Company funded $4.4 million and $7.0 million of these commitments during the years ended December 31, 2001 and 2000, respectively.

Commercial Real Estate Finance

The commercial real estate finance portfolio, investment activity and yields as of and for the years ended December 31, 2001, 2000 and 1999 were as follows:

($ in millions)	2001	2000	1999
Portfolio at value:			
CMBS	$582.6	$311.3	$277.7
Loans and other	151.9	194.2	242.3
Total portfolio	$734.5	$505.5	$520.0
Investments funded	$392.6	$149.0	$288.7
Change in accrued or reinvested interest	$2.7	$1.1	$2.8
Repayments	$30.7	$24.3	$50.8
Sales	$130.0	$151.7	$86.1
Yield			

13.5% 13.1% 12.3%

During 1998, the Company reduced its commercial mortgage loan origination activity for its own portfolio due to declining interest rates and began to sell its loans to other lenders. Then, beginning in the fourth quarter of 1998, the Company began to take advantage of a unique market opportunity to acquire non-investment grade CMBS at significant discounts from the face amount of the bonds. Turmoil in the capital markets at that time created a lack of liquidity for the traditional buyers of non-investment grade bonds. As a result, yields on these collateralized bonds increased, thus providing an attractive investment opportunity. The Company believes that CMBS is an attractive asset class because of the yields that can be earned on a security that is secured by commercial mortgage loans, and ultimately commercial properties. The Company plans to continue its CMBS investment activity, however, in order to maintain a balanced portfolio, the Company expects that CMBS will continue to represent approximately 20% to 25% of total assets. The Company s CMBS investment activity level will be dependent upon its ability to invest in CMBS at attractive yields.

The non-investment grade CMBS bonds in which the Company invests are junior in priority for payment of principal to the more senior tranches of the related CMBS bond issuance. Cash flow from the underlying mortgages generally is allocated first to the senior tranches, with the most senior tranches having a priority right to the cash flow. Then, any remaining cash flow is allocated, generally, among the other tranches in order of their relative seniority. To the extent there are defaults and unrecoverable losses on the underlying mortgages resulting in reduced cash flows, the Company s most subordinate tranch will bear this loss first. At December 31, 2001, the Company s CMBS bonds were subordinate to 91% to 97% of the tranches of various CMBS bond issuances.

Given that the non-investment grade CMBS bonds in which the Company invests are junior in priority for payment of principal, the Company invests in these CMBS at an approximate discount of 50% from the face amount of the bonds. During 2001, the Company invested $365.8 million in CMBS bonds with a face value of $661.4 million and a weighted average yield to maturity of 14.0%. In 2001, the Company also purchased $24.6 million in non-investment grade preferred shares related to a collateralized debt obligation issuance secured by CMBS and investment grade REIT bonds. The Company acts as the collateral disposition consultant for this issuance. During 2000 and 1999, the Company invested $124.3 million and $245.9 million in CMBS bonds, with a face amount of $244.6 million and $507.9 million, and a weighted average yield to maturity of 14.7% and 14.6%, respectively.

The underlying pools of mortgage loans that are collateral for the Company s new CMBS bond investments for the years ended December 31, 2001, 2000 and 1999 had respective underwritten loan to value (LTV) and underwritten debt service coverage ratios (DSCR) as follows:

	2001		2000		1999	
Loan to Value Ranges ($ in millions)	**Amount**	**Percentage**	**Amount**	**Percentage**	**Amount**	**Percentage**
Less than 60%	$1,259.7	15%	$577.1	14%	$813.7	11%
60-65%	941.6	11	402.8	10	439.6	6
65-70%	1,140.6	14	648.1	16	1,342.5	17
70-75%	2,400.4	29	1,450.9	36	2,396.0	31
75-80%	2,466.4	30	958.9	23	2,500.8	33
Greater than 80%	119.6	1	36.6	1	150.7	2
Total	$8,328.3	100%	$4,074.4	100%	$7,643.3	100%

Weighted average LTV		
69.7%	70.2%	71.1%

Debt Service Coverage Ratio Ranges ($ in millions)	2001		2000		1999	
	Amount	Percentage	Amount	Percentage	Amount	Percentage
Less than 1.25	$ 1,822.0	22%	$ 1,232.0	30%	$ 1,868.2	25%
1.26-1.50	5,008.3	60	2,204.5	54	4,452.9	58
1.51-1.75	855.0	10	341.8	8	893.8	12
1.76-2.00	158.2	2	99.1	3	182.3	2
Greater than 2.00	484.8	6	197.0	5	246.1	3
Total	$8,328.3	100%	$4,074.4	100%	$7,643.3	100%

Weighted average DSCR	1.48	1.35	1.29

As a part of the Company s strategy to maximize its return on equity capital, the Company sold CMBS bonds rated BB+, BB and BB- during 2001 and 2000 totaling

$124.5 million and $98.7 million, respectively. These bonds had an effective yield of 10.3% and 11.5%, and were sold for $126.8 million and $102.5 million, respectively, resulting in realized gains on the sales. In addition, in February 2002, the Company completed the sale of $122.6 million of CMBS bonds rated BB+, BB and BB- that were purchased during 2001, 2000 and 1999. The sale of these lower-yielding bonds increased the Company s overall liquidity.

The effective yield on the Company s CMBS portfolio at December 31, 2001, 2000 and 1999 was 14.8%, 15.4% and 14.6%, respectively. The yield on the CMBS portfolio at any point in time will vary depending on the concentration of lower yielding BB+, BB and BB- securities held in the portfolio. At December 31, 2001, 2000 and 1999, the unamortized discount related to the CMBS portfolio was $611.9 million, $364.9 million and $291.5 million, respectively. At December 31, 2001, the CMBS bonds owned by the Company were secured by approximately 3,800 commercial mortgage loans with a total outstanding principal balance of $20.5 billion.

The Company has been liquidating much of its whole commercial mortgage loan portfolio so that it can redeploy the proceeds into higher yielding assets. For the years ended December 31, 2001, 2000 and 1999, the Company sold $5.5 million, $53.0 million and $86.1 million, respectively, of commercial mortgage loans. At December 31, 2001, the Company s whole commercial real estate loan portfolio had been reduced to $79.6 million from $106.4 million at December 31, 2000.

Other Assets and Other Liabilities

Because the Company invests in BB+, BB and BB- CMBS bonds, which are purchased at prices that are based on the 10-year Treasury rate, the Company has entered into transactions with a financial institution to hedge against movement in Treasury rates on certain of these CMBS bonds. These transactions involved the Company receiving the proceeds from the sale of borrowed Treasury securities, with the obligation to replenish the borrowed Treasury securities at a later date based on the then current market price. The Company recorded the proceeds of the sale of the borrowed Treasury securities of $48.5 million as an other asset, and the related obligation to replenish the borrowed Treasury securities of $47.3 million, which represents the fair value of the obligation, as an other liability at December 31, 2001. The Company recorded the difference between the sales proceeds and the related obligation of $1.2 million as unrealized appreciation in 2001.

RESULTS OF OPERATIONS

Comparison of the Years Ended December 31, 2001, 2000 and 1999

The following table summarizes the Company s operating results for the years ended December 31, 2001, 2000 and 1999:

	2001	2000	Change	Percent Change	2000	1999	Change	Percent Change
	(in thousands, except per share amounts)							
Interest and Related Portfolio Income								
Interest and dividends	$240,464	$182,307	$58,157	32%	$182,307	$121,112	$61,195	51%
Premiums from loan dispositions	2,504	16,138	(13,634)	(84%)	16,138	14,284	1,854	13%
Fees and other income	46,142	13,144	32,998	251%	13,144	5,744	7,400	129%
Total interest and related portfolio income	289,110	211,589	77,521	37%	211,589	141,140	70,449	50%

Expenses

Interest	65,104	57,412	7,692	13%	57,412	34,860	22,552	65%
Employee	29,656	26,025	3,631	14%	26,025	22,889	3,136	14%
Administrative	15,299	15,435	(136)	(1%)	15,435	12,350	3,085	25%
Total operating expenses	110,059	98,872	11,187	11%	98,872	70,099	28,773	41%
Net operating income before net realized and unrealized gains	179,051	112,717	66,334	59%	112,717	71,041	41,676	59%

Net Realized and Unrealized Gains

Net realized gains
661 15,523 (14,862) (96%) 15,523 25,391 (9,868) (39%)
Net unrealized gains
20,603 14,861 5,742 39% 14,861 2,138 12,723 595%

Total net realized and unrealized gains
21,264 30,384 (9,120) (30%) 30,384 27,529 2,855 10%

Income before income taxes
200,315 143,101 57,214 40% 143,101 98,570 44,531 45%
Income tax benefit
412 412 %

Net increase in net assets resulting from operations							
$200,727	$143,101	$57,626	40%	$143,101	$98,570	$44,531	45%
Diluted net operating income per share							
$1.92	$1.53	$0.39	25%	$1.53	$1.18	$0.35	30%
Diluted earnings per share							
$2.16	$1.94	$0.22	11%	$1.94	$1.64	$0.30	18%

Weighted average shares outstanding diluted							
93,003	73,472	19,531	27%	73,472	60,044	13,428	22%

Net increase in net assets resulting from operations (NIA) results from total interest and related portfolio income earned, less total expenses incurred in the operations of the Company, plus net realized and unrealized gains or losses.

Total interest and related portfolio income includes interest income, premiums from loan dispositions and fees and other income.

The increase in interest income earned results primarily from continued growth of the Company s investment portfolio and the Company s focus on increasing its overall portfolio yield. The Company s investment portfolio, excluding non-interest bearing equity interests in portfolio companies, increased by 25% to $1,842.4 million at December 31, 2001 from $1,471.8 million at December 31, 2000, and increased by 29% during 2000 from $1,141.2 million at December 31, 1999. The weighted average yield on the interest-bearing investments in the portfolio at December 31, 2001, 2000 and 1999 was as follows:

Included in net premiums from loan dispositions are premiums from loan sales and premiums received on the early repayment of loans. Premiums from loan sales were $0.5 million, $13.3 million and $10.5 million for the years ended December 31, 2001, 2000 and 1999, respectively. This premium income for 2000 and 1999 was higher primarily due to the loan sale activities of Allied Capital Express prior to its merger with BLX.

Prepayment premiums were $2.0 million, $2.8 million and $3.8 million for the years ended December 31, 2001, 2000 and 1999, respectively. While the scheduled maturities of private finance and commercial real estate loans range from five to ten years, it is not unusual for the Company s borrowers to refinance or pay off their debts to the Company ahead of schedule. Because the Company seeks to finance primarily seasoned, performing companies, such companies at times can secure lower cost financing as their balance sheets strengthen, or as more favorable interest rates become available. Therefore, the Company generally structures its loans to require a prepayment premium for the first three to five years of the loan.

Fees and other income primarily include fees related to financial structuring, diligence, management services to portfolio companies, guaranties and other advisory services. The Company generates fee income for the transaction services and management services that it provides. As a BDC, the Company is required to make significant managerial assistance available to the companies in its investment portfolio.

Fees and other income for the year ended December 31, 2001 primarily included fees of $15.5 million related to structuring and diligence, fees of $16.6 million related to transaction services provided to portfolio companies, and fees of $13.1 million related to management services provided to portfolio companies, other advisory services and guaranty fees. Fees and other income for the years ended December 31, 2000 and 1999 primarily included structuring and diligence fees of $6.0 million and $0.3 million, respectively, and management services and advisory fees of $3.1 million and $3.2 million, respectively. Fees and other income are generally related to specific transactions or services, and therefore may vary substantially from period to period. Points or loan origination fees that represent yield enhancement on a loan are capitalized and amortized into interest income over the life of the loan.

Operating expenses include interest, employee and administrative expenses. The Company s single largest expense is interest on indebtedness. The fluctuations in interest expense during 2001, 2000 and 1999 are attributable to changes in the level of borrowings by the Company and the related interest rate charged thereon. The Company s borrowing activity and weighted average interest cost, including related fees and expenses, were as follows:

($ in millions)	2001	2000	1999
Total outstanding debt	$1,020.8	$786.6	$592.9
Average outstanding debt	$847.1	$707.4	$461.5
Weighted average cost	7.0%	8.3%	7.9%
BDC asset coverage*	245%	245%	228%

* As a BDC, the Company is generally required to maintain a ratio of 200% of total assets to total borrowings.

Employee expenses include salaries and employee benefits. The increases in salaries and employee benefits for the periods presented reflect wage increases and the experience level of employees hired. Total employees were 97, 97 and 129 at December 31, 2001, 2000 and 1999, respectively. As part of the recapitalization of Allied Capital Express discussed above, 37 employees of the Company were transferred to BLX at the end of 2000. Expenses related to these employees are reflected in employee expense for the years ended December 31, 2000 and 1999.

Administrative expenses include the leases for the Company s headquarters in Washington, DC and its regional offices, travel costs, stock record expenses, directors fees, legal and accounting fees and various other expenses. Administrative expenses for the years ended December 31, 2000 and 1999 included expenses related to Allied Capital Express regional offices. The cost of these regional offices was transferred to BLX at the beginning of 2001. For the years ended December 31, 2001, 2000 and 1999, employee and administrative costs as a percentage of total interest and related portfolio income less interest expense plus net realized and unrealized gains was 18%, 19% and 21%, respectively.

Net realized gains resulted from the sale of equity securities associated with certain private finance investments and the realization of unamortized discount resulting from the sale and early repayment of private finance loans, commercial mortgage loans and CMBS, offset by losses on investments. Net realized and unrealized gains for the years ended December 31, 2001, 2000 and 1999 were as follows:

(in millions)	2001	2000	1999
Realized gains	$10.1	$28.6	$31.5
Realized losses	(9.4)	(13.1)	(6.1)
Net realized gains	$0.7	$15.5	$25.4
Net unrealized gains	$20.6	$14.9	$2.1

Realized gains during 2001 primarily resulted from transactions involving three private finance portfolio companies-FTI Consulting, Inc. ($4.6 million), SunSource Inc. ($2.5 million), and Southwest PCS, LLC ($0.8 million), and the sale of CMBS ($1.7 million). The Company reversed previously recorded unrealized appreciation of $6.5 million when these gains were realized in 2001. Realized gains during 2000 and 1999 resulted primarily from transactions involving eight and six portfolio companies, respectively, and the Company reversed previously recorded unrealized appreciation of $7.5 million and $14.6 million, respectively, when these gains were realized.

Realized losses in 2001, 2000 and 1999 represented 0.4%, 0.7% and 0.5% of the Company s total assets, respectively. Realized losses during 2001 resulted primarily from three private finance portfolio investments-Pico Products, Inc. ($2.9 million), Allied Office Products, Inc. ($2.5 million), and Genesis Worldwide, Inc. ($1.1 million), and the continued liquidation of the Company s whole loan commercial real estate portfolio. Losses realized in 2001 had been recognized in NIA over time as unrealized depreciation when the Company determined that the respective portfolio security s value had become impaired. Thus, the Company reversed previously recorded unrealized depreciation totaling $8.9 million, $12.0 million and $5.4 million when the related losses were realized in 2001, 2000 and 1999, respectively.

As discussed in the private finance section above, investment activity for 2001 was at a slower pace than prior years. This lower level of activity is reflected in the lower amount of net realized gains in 2001 as compared to 2000 and 1999.

The Company, as a BDC, invests primarily in illiquid securities including the debt and equity of private companies and non-investment grade CMBS. The Company s investments generally take many months to complete. The structure of each debt and equity security is specifically negotiated and includes many terms governing interest rate, repayment terms,

prepayment penalties, financial covenants, operating covenants, ownership parameters, dilution parameters, liquidation preferences, voting rights, and put or call rights. The Company s investments are generally subject to restrictions on resale and generally have no established trading market. The Company values its securities at fair value as determined in good faith by the Company s Board of Directors in accordance with the Company s valuation policy. The Company determines fair value to be the amount for which an investment could be exchanged in an orderly disposition over a reasonable period of time between willing parties other than in a forced or liquidation sale.

The Company s valuation policy considers the fact that privately negotiated securities increase in value over a long period of time, that the Company does not intend to trade the securities, and that no ready market exists. The Company s valuation policy is intended to provide a consistent, conservative basis for establishing the fair value of the portfolio. Unlike banks, the Company is not permitted to provide a general reserve for anticipated loan losses. Instead, the Company must value each individual investment on a quarterly basis. The Company will record unrealized depreciation on investments when it believes that an asset has been impaired and full collection for the loan or realization of an equity security is doubtful. Conversely, the Company will record unrealized appreciation if it has a clear indication that the underlying portfolio company has appreciated in value and, therefore, the Company s security has also appreciated in value. Under its valuation policy, the Company does not consider temporary changes in the capital markets, such as interest rate movements or changes in the public equity markets, in order to determine whether an investment in a private company has been impaired or whether such an investment has increased in value. The value of investments in public securities is determined using quoted market prices, discounted for illiquidity or restrictions on resale.

During 2001, the Company increased the value of its equity investment in BLX by $15.5 million and recorded unrealized appreciation. The Company also increased the value of its investment in Wyo-Tech Acquisition Corporation by $37.0 million. In addition to BLX and Wyo-Tech, the Company increased the value of other portfolio investments by a total of $32.9 million for the year ended December 31, 2001. These companies increased in value because of their continued positive performance and valuation data that would indicate that a valuation increase was necessary.

During the year ended December 31, 2001, the Company decreased the value of and recorded unrealized depreciation on its investments in Startec Global Communications Corporation by $14.9 million, Galaxy American Communications, LLC by $10.4 million, Schwinn Holdings Corporation by $8.8 million, Avborne, Inc. by $8.4 million and NETtel Communications, Inc. by $7.0 million. In addition, the Company recorded a net decrease in the value of other portfolio investments by a total of $18.9 million for the year ended December 31, 2001.

The Company employs a standard grading system for the entire portfolio. Grade 1 is used for those investments from which a capital gain is expected. Grade 2 is used for investments performing in accordance with plan. Grade 3 is used for investments that require closer monitoring; however, no loss of interest or principal is expected. Grade 4 is used for investments for which some loss of contractually due interest is expected, but no loss of principal is expected. Grade 5 is used for investments for which some loss of principal is expected and the investment is written down to net realizable value.

At December 31, 2001 and 2000, the Company s portfolio was graded as follows:

Grade ($ in millions)	2001 Portfolio at Value	2001 Percentage of Total Portfolio	2000 Portfolio at Value	2000 Percentage of Total Portfolio
1	$603.3	25.9%	$208.3	11.7%
2	1,553.8	66.7	1,461.7	81.7
3	79.5	3.4	15.4	0.9
4	44.5	1.9	76.0	4.2
5	48.5	2.1	26.6	1.5
	$2,329.6	100.0%	$1,778.0	100.0%

Total Grade 4 and 5 assets as a percentage of the total portfolio at value at December 31, 2001 and 2000 were 4.0% and 5.7%, respectively. The Company expects that a certain number of portfolio companies will be in the Grade 4 or 5 category from time to time. Part of the business of private finance is working with troubled portfolio companies to improve their businesses and protect the Company s investment. The number of portfolio companies and related investment amounts included in Grade 4 and 5 may fluctuate significantly from period to period as the Company helps these companies work through their problems. The Company continues to follow its historical practices of working with a troubled portfolio company in order to recover the maximum amount of the Company s investment, but records unrealized depreciation for the expected amount of the potential loss when such exposure is identified.

For the total investment portfolio, loans greater than 90 days delinquent were $39.1 million at value at December 31, 2001, or 1.7% of the total portfolio. Included in this category are loans valued at $14.1 million that were secured by commercial real estate. Loans greater than 90 days delinquent at December 31, 2000 were $57.3 million at value, or 3.2% of the total portfolio, which included $14.1 million that were secured by commercial real estate. Loans greater than 120 days delinquent generally do not accrue interest. As a provider of long-term privately negotiated investment capital, it is not atypical to defer payment of principal or interest from time to time. As

a result, the amount of the portfolio that is greater than 90 days delinquent may vary from quarter to quarter. The terms of the private finance agreements frequently provide an opportunity for portfolio companies to restructure their debt and equity capital. During such restructuring, the Company may not receive or accrue interest or dividend payments. The investment portfolio is priced to provide current returns for shareholders assuming that a portion of the portfolio at any time may not be accruing interest currently. The Company also prices its investments for a total return including interest or dividends plus capital gains from the sale of equity securities. Therefore, the amount of loans greater than 90 days delinquent is not necessarily an indication of future principal loss or loss of anticipated investment return. The Company s portfolio grading system is used as a means to assess loss of investment return (Grade 4 assets) or loss of investment principal (Grade 5 assets).

At December 31, 2001 and 2000, 0.42% and 0.38%, respectively, of the loans in the underlying collateral pool for the Company s CMBS portfolio were over 30 days delinquent. The Company closely monitors the performance of all of the loans in the underlying collateral pools securing its CMBS investments. The Company believes that the

current performance of the underlying loans would not require an adjustment to its yield assumptions, but these assumptions will continue to be monitored and adjusted in the future, if necessary.

The Company has elected to be taxed as a regulated investment company (RIC) under Subchapter M of the Internal Revenue Code of 1986, as amended (Code). As long as the Company qualifies as a RIC, the Company is not taxed on its investment company taxable income or realized capital gains, to the extent that such income or gains are distributed, or deemed to be distributed, to shareholders on a timely basis. Annual tax distributions may differ from NIA for the fiscal year due to timing differences in the recognition of income and expenses, returns of capital and net unrealized appreciation or depreciation, which are not included in taxable income.

In order to maintain its RIC status, the Company must, in general, (1) continue to qualify as a BDC; (2) derive at least 90% of its gross income from dividends, interest, gains from the sale of securities and other specified types of income; (3) meet investment diversification requirements as defined in the Code; and (4) distribute annually to shareholders at least 90% of its investment company taxable income as defined in the Code. The Company intends to take all steps necessary to continue to meet the RIC qualifications. However, there can be no assurance that the Company will continue to qualify for such treatment in future years.

All per share amounts included in management s discussion and analysis have been computed using the weighted average shares used to compute diluted earnings per share, which were 93.0 million, 73.5 million and 60.0 million for the years ended December 31, 2001, 2000 and 1999, respectively. The increases in the weighted average shares reflect the issuance of new shares.

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

Cash and Cash Equivalents

At December 31, 2001, the Company had $0.9 million in cash and cash equivalents. The Company invests otherwise uninvested cash in U.S. government-or agency-issued or guaranteed securities that are backed by the full faith and credit of the United States, or in high quality, short-term repurchase agreements fully collateralized by such securities. The Company s objective is to manage to a low cash balance and fund new originations with its revolving line of credit.

Debt

The Company had outstanding debt at December 31, 2001, as follows:

($ in millions)	Facility Amount	Amount Outstanding	Annual Interest Cost(1)	Annual Portfolio Return to Cover Interest Payments(2)
Notes payable and debentures:				
Unsecured long-term notes	$694.0	$694.0	7.8%	2.2%
SBA debentures	101.8	94.5	7.7%	0.3%
Auction rate reset note	81.9	81.9	3.9%	0.1%
OPIC loan	5.7	5.7	6.6%	0.0%
Total notes payable and debentures	$883.4	$876.1	7.4%	2.6%
Revolving line of credit	497.5	144.7	4.7%	0.3%
Total debt	$1,380.9	$1,020.8	7.0%	2.9%

(1) The annual interest cost includes the cost of commitment fees and other facility fees.
(2) The annual portfolio return to cover interest payments is calculated as the December 31, 2001 annualized cost of debt per class of financing divided by total assets at December 31, 2001.

Unsecured Long-Term Notes. The Company has issued long-term debt to institutional lenders, primarily insurance companies. The notes have five-or seven-year maturities, with maturity dates beginning in 2003. The notes require payment of interest only semi-annually, and all principal is due upon maturity.

On October 30, 2001, the Company issued $150 million of five-year unsecured long-term debt, financed primarily by insurance companies. The five-year notes were priced at 7.16% and have substantially the same terms as the Company s existing unsecured long-term notes.

SBA Debentures. The Company, through its SBIC subsidiary, has debentures payable to the SBA with terms of ten years. The notes require payment of interest only semi-annually, and all principal is due upon maturity. Under the SBIC program, the Company may borrow up to $111.7 million from the SBA. At December 31, 2001, the Company had a commitment to borrow up to an additional $7.3 million above the amount outstanding from the SBA. The commitment expires on September 30, 2005.

Auction Rate Reset Note. The Company has an Auction Rate Reset Senior Note Series A that matures on December 2, 2002 and bears interest at the three-month London Inter-Bank Offered Rate (LIBOR) plus 1.75%, which adjusts quarterly. Interest is due quarterly, and the Company, at its option, may pay or defer and capitalize such interest payments. The amount outstanding on the note will increase as interest due is deferred and capitalized. As a means to repay the note, the Company has entered into an agreement to issue $81.9 million of debt, equity or other securities in one or more public or private transactions, or prepay the Auction Rate Reset Note, on or before August 31, 2002. If the note is prepaid, the Company will pay a fee equal to 0.5% of the aggregate amount of the note outstanding.

Revolving Line of Credit. As of December 31, 2001, the Company has a $497.5 million unsecured revolving line of credit that expires in August 2003, with the right to extend maturity for one additional year at the Company s sole option under substantially similar terms. This facility may be expanded up to $600 million. The credit facility bears interest at a rate equal to (i) the one-month LIBOR plus 1.25% or (ii) the higher of (a) the Bank of America, N.A. prime rate or (b) the Federal Funds rate plus

0.50%. The credit facility requires monthly payments of interest, and all principal is due upon maturity.

Equity Capital and Dividends

The Company raises debt and equity capital for continued investment in its portfolio. Because the Company is a RIC, it distributes its income and requires external capital for growth. Because the Company is a BDC, it is limited in the amount of debt capital it may use to fund its growth, since it is generally required to maintain a ratio of 200% of total assets to total borrowings, or approximately a 1 to 1 debt to equity capital ratio.

To support its growth during the year ended December 31, 2001, the Company raised $286.9 million in new equity capital through the sale of shares from its shelf registration statement. The Company issues equity from time to time when it has a clear use of proceeds for attractive investment opportunities. Historically, this process has enabled the Company to raise equity on an accretive basis for existing shareholders. In addition, the Company raised $11.5 million in new equity capital through the issuance of shares in the acquisition of one portfolio investment and through the dividend reinvestment plan. At December 31, 2001, total shareholders equity had increased to $1,352.1 million.

The Company s Board of Directors reviews the dividend quarterly, and may adjust the quarterly dividend throughout the year as the Company s earnings momentum builds. For the first, second, third and fourth quarter of 2001, the Board declared a $0.49, $0.50, $0.51 and $0.51 per common share dividend, respectively. For the first quarter of 2002, the Board declared a dividend of $0.53 per common share. Dividends are paid from the Company s taxable income.

As a result of growth in ordinary taxable income combined with the increased size and diversity of the Company s portfolio and its projected future capital gains, the Company s Board of Directors will continue to evaluate whether to retain or distribute capital gains as they occur. The Company s dividend policy allows the Company to continue to distribute some capital gains, but will also allow the Company to retain gains that exceed a normal capital gains distribution level, and therefore avoid any unusual spike in dividends in any one year. The dividend policy also enables the Board of Directors to selectively retain gains to support future growth.

The Company plans to maintain a strategy of financing its operations, dividend requirements and future investments with cash from operations, through borrowings under short- or long-term credit facilities or other debt securities, through asset sales, or through the sale or issuance of new equity capital. The Company maintains a matched-funding philosophy that focuses on matching the estimated maturities of its loan and investment portfolio to the estimated maturities of its borrowings. The Company uses its short-term credit facilities as a means to bridge to long-term financing, which may or may not result in temporary differences in the matching of estimated maturities. The Company evaluates its interest rate exposure on an ongoing basis. To the extent deemed necessary, the Company may hedge variable and short-term interest rate exposure through interest rate swaps or other techniques. At December 31, 2001, the Company s debt to equity ratio was 0.75 to 1 and weighted average cost of funds was 7.0%. There are no significant maturities of long-term debt until 2003. The Company believes that it has access to capital sufficient to fund its ongoing investment and operating activities, and from which to pay dividends.

SENIOR SECURITIES

Information about our senior securities is shown in the following tables as of the fiscal year ended December 31, unless otherwise noted. The indicates information which the Commission expressly does not require to be disclosed for certain types of senior securities.

Class and Year	Total Amount Outstanding Exclusive of Treasury Securities(1)	Asset Coverage Per Unit(2)	Involuntary Liquidating Preference Per Unit(3)	Average Market Value Per Unit(4)
Unsecured Long-term Notes Payable				
1992	$0	$0	$	N/A
1993	0	0		N/A
1994	0	0		N/A
1995	0	0		N/A
1996	0	0		N/A
1997	0	0		N/A
1998	180,000,000	2,734		N/A
1999	419,000,000	2,283		N/A
2000	544,000,000	2,445		N/A
2001	694,000,000	2,453		N/A
SBA Debentures(5)				
1992	$49,800,000	$5,789	$	N/A
1993	49,800,000	6,013		N/A
1994	54,800,000	3,695		N/A
1995	61,300,000	2,868		N/A
1996	61,300,000	2,485		N/A
1997	54,300,000	2,215		N/A
1998	47,650,000	2,734		N/A
1999	62,650,000	2,283		N/A
2000	78,350,000	2,445		N/A
2001	94,500,000	2,453		N/A
Auction Rate Reset Note				
1992	$0	$0	$	N/A
1993				

	0	0	N/A
1994	0	0	N/A
1995	0	0	N/A
1996	0	0	N/A
1997	0	0	N/A
1998	0	0	N/A
1999	0	0	N/A
2000	76,598,000	2,445	N/A
2001	81,856,000	2,453	N/A

Class and Year	Total Amount Outstanding Exclusive of Treasury Securities(1)	Asset Coverage Per Unit(2)	Involuntary Liquidating Preference Per Unit(3)	Average Market Value Per Unit(4)
Overseas Private Investment Corporation Loan				
1992	$0	$0	$	N/A
1993	0	0		N/A
1994	0	0		N/A
1995	0	0		N/A
1996	8,700,000	2,485		N/A
1997	8,700,000	2,215		N/A
1998	5,700,000	2,734		N/A
1999	5,700,000	2,283		N/A
2000	5,700,000	2,445		N/A
2001	5,700,000	2,453		N/A
Revolving Lines of Credit				
1992	$0	$0	$	N/A
1993	0	0		N/A
1994	32,226,000	3,695		N/A
1995	20,414,000	2,868		N/A
1996	45,099,000	2,485		N/A
1997	38,842,000	2,215		N/A
1998	95,000,000	2,734		N/A
1999	82,000,000	2,283		N/A
2000	82,000,000	2,445		N/A
2001	144,750,000	2,453		N/A
Master Repurchase Agreement and Master Loan and Security Agreement				
1992	$0	$0	$	N/A
1993	0	0		N/A
1994	23,210,000	3,695		N/A

1995	0	0	N/A
1996	85,775,000	2,485	N/A
1997	225,821,000	2,215	N/A
1998	6,000,000	2,734	N/A
1999	23,500,000	2,283	N/A
2000	0	0	N/A
2001	0	0	N/A

Class and Year	Total Amount Outstanding Exclusive of Treasury Securities(1)	Asset Coverage Per Unit(2)	Involuntary Liquidating Preference Per Unit(3)	Average Market Value Per Unit(4)
Senior Note Payable(6)				
1992	$20,000,000	$5,789	$	N/A
1993	20,000,000	6,013		N/A
1994	20,000,000	3,695		N/A
1995	20,000,000	2,868		N/A
1996	20,000,000	2,485		N/A
1997	20,000,000	2,215		N/A
1998	0	0		N/A
1999	0	0		N/A
2000	0	0		N/A
2001	0	0		N/A
Bonds Payable				
1992	$0	$0	$	N/A
1993	0	0		N/A
1994	0	0		N/A
1995	98,625,000	2,868		N/A
1996	54,123,000	2,485		N/A
1997	0	0		N/A
1998	0	0		N/A
1999	0	0		N/A
2000	0	0		N/A
2001	0	0		N/A
Redeemable Cumulative Preferred Stock(5)				
1992	$1,000,000	$526	$100	N/A
1993	1,000,000	546	100	N/A
1994	1,000,000	351	100	N/A
1995	1,000,000	277	100	N/A
1996	1,000,000	242	100	N/A

1997
1,000,000 217 100 N/A
1998
1,000,000 267 100 N/A
1999
1,000,000 225 100 N/A
2000
1,000,000 242 100 N/A
2001
1,000,000 244 100 N/A **Non-Redeemable Cumulative Preferred Stock(5)**
1992
$6,000,000 $526 $100 N/A
1993
6,000,000 546 100 N/A
1994
6,000,000 351 100 N/A
1995
6,000,000 277 100 N/A
1996
6,000,000 242 100 N/A
1997
6,000,000 217 100 N/A
1998
6,000,000 267 100 N/A
1999
6,000,000 225 100 N/A
2000
6,000,000 242 100 N/A
2001
6,000,000 244 100 N/A

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(1) Total amount of each class of senior securities outstanding at the end of the period presented.

(2) The asset coverage ratio for a class of senior securities representing indebtedness is calculated as the Company s consolidated total assets, less all liabilities and indebtedness not represented by senior securities, divided by senior securities representing indebtedness. This asset coverage ratio is multiplied by $1,000 to determine the Asset Coverage Per Unit. The asset coverage ratio for a class of senior securities that is preferred stock is calculated as the Company s consolidated total assets, less all liabilities and indebtedness not represented by senior securities, divided by senior securities representing indebtedness, plus the involuntary liquidation preference of the preferred stock (see footnote 3). The Asset Coverage Per Unit for preferred stock is expressed in terms of dollar amounts per share.

(3) The amount to which such class of senior security would be entitled upon the involuntary liquidation of the issuer in preference to any security junior to it.

(4) Not applicable, as senior securities are not registered for public trading.

(5) Issued by the Company s SBIC subsidiary to the SBA. These categories of senior securities are not subject to the asset coverage requirements of the 1940 Act. See Certain Government Regulations SBA Regulations.

(6) The Company was the obligor on $15 million of the senior notes. The Company s SBIC subsidiary was the obligor on the remaining $5 million, which is not subject to the asset coverage requirements of the 1940 Act.

BUSINESS

As a business development company, we provide long-term debt and equity investment capital to support the expansion of growing businesses in a variety of industries and in diverse geographic locations. We have been investing in growing businesses for over 40 years and have financed thousands of private companies nationwide. Today, our investment and lending activity is focused in two areas:

- Private finance and

- Commercial real estate finance, or the investment in non-investment grade commercial mortgage-backed securities (CMBS).

Our investment portfolio consists primarily of long-term unsecured loans with equity features, equity investments in middle market companies, which may or may not constitute a controlling equity interest, commercial mortgage-backed securities, and commercial mortgage loans. At December 31, 2001, our investment portfolio totaled $2.3 billion. Our investment objective is to achieve current income and capital gains.

Private Finance

We participate in the private capital markets nationwide by providing privately negotiated long-term debt and equity investment capital. Our private finance investment activity is generally focused on providing junior capital, in the form of subordinated debt with equity features, such as warrants or options. In certain situations, we may also take a controlling equity position in a company. At December 31, 2001, 69% of the private finance portfolio consisted of loans and debt securities, and 31% consisted of equity securities. Our nationwide private finance portfolio includes investments in a wide variety of industries, including non-durable consumer products, business services, financial services, light industrial products, retail, education, telecommunications and broadcasting and cable.

Capital providers for the finance of private companies can be generally categorized as shown in the diagram below:

Capital Provider
Banks Commercial
Finance Companies Private
Placement/ High Yield
Private Mezzanine Funds
Allied Capital Private
Equity Funds

Primary
Business
Focus Senior, short- term
debt Asset-based
lending Large
credits
(private
> $50 mm)
(public
> $150 mm) Unsecured
long- term debt with
warrants

Preferred and common

equity Unsecured long-term debt with warrants

Preferred and common equity Equity

Typical Pricing Spectrum* LIBOR+ [graphic of arrow stretching between LIBOR+ and 30%+] 30%+

* Based on market experience of our marketing and investment professionals.

Banks are primarily focused on providing senior secured and unsecured short-term debt. They typically do not provide meaningful long-term unsecured loans. Commercial finance companies are primarily focused on providing senior secured long-term debt. The private placement and high-yield debt markets are focused primarily on very large financing transactions, typically in excess of the financings we do. We generally do not

compete with banks, commercial finance companies, or the private placement/high yield market. Instead, we compete directly with the private mezzanine sector of the private capital market. Private mezzanine funds are also focused on providing unsecured long-term debt to private companies for the types of transactions discussed above. We believe that we have key structural and operational advantages when compared to private mezzanine funds.

Our scale of operations, equity capital base, and successful track record as a private finance investor has enabled us to borrow long-term capital to leverage our returns on our common equity. Therefore, our access to debt capital reduces our total cost of capital. In many cases, a private mezzanine fund is unable to access the debt capital markets, and therefore must achieve an unleveraged equity return for their investors. Our lower cost of capital gives us a pricing advantage when competing for new investments. In addition, the perpetual nature of our corporate structure enables us to be a better long-term partner for our portfolio companies than a traditional mezzanine fund, which typically has a finite life.

When assessing a prospective investment, we look for companies with certain characteristics, which may or may not include market leadership in a niche, critical mass and longevity, and a sustainable cash flow. We also look for companies that, because of their industry and business plan, can demonstrate minimal vulnerability to changes in economic cycles. Since our investments are primarily unsecured in nature, when investing debt capital, we look for companies in industries that are less cyclical, cash flow intensive, and can demonstrate a high return on their invested capital. When our investments are equity-focused, we look for companies where the potential for high growth exists. We generally do not target companies in industries where businesses tend to be vulnerable to changes in economic cycles, are capital intensive, have low returns on their invested capital and have little growth potential. We generally target and do not target the following industries, though we will consider investments in any industry if the prospective company demonstrates unique characteristics that make it an attractive investment opportunity:

Industries Targeted

Less Cyclical/Cash Flow Intensive/ High Return on Capital

Consumer products
Business services
Financial services
Light industrial products
Broadcasting/Cable

Industries Not Targeted

Cyclical/Capital Intensive/ Low Return on Capital

Heavy equipment
Natural resources
Commodity retail
Low value-add distribution
Agriculture
Transportation

Over our 40-year history, we have developed and maintained relationships with dozens of intermediaries including investment banks, mortgage brokers, financial services companies and private mezzanine and equity sponsors through

which we source investment opportunities. Through these relationships, especially those with equity sponsors, we have been able to strengthen our position as a long-term investor. For the transactions in which we have provided debt capital, an equity sponsor provides a reliable source of additional equity capital if the portfolio company requires additional financing. Private equity sponsors also help us confirm our own due diligence findings when assessing a new investment opportunity, and they provide assistance and leadership to the portfolio company s management team throughout our investment period.

Our private financing is generally used to fund growth, buyouts, acquisitions, recapitalizations, note purchases, and bridge financings. We generally invest in private companies though, from time to time, we may invest in public companies that lack access to public capital or whose securities may not be marginable. We target two types of companies when seeking new investments. The first type of company we seek is a market leader in a stable industry that has demonstrated over many years of operations that it can successfully achieve its business plan and thereby achieve our investment objective. The second type of company we seek is an emerging company in a growing industry that is positioned for significant growth. We have spent over 40 years refining our highly selective investment discipline, which is founded on seeking investments in companies that have key characteristics and that operate in specific industries.

Our private finance mezzanine investing activities target a market niche between the senior debt financing provided by traditional lenders, such as banks, commercial finance companies and insurance companies, and the equity capital provided by private equity investors. Our private finance mezzanine investments are generally structured as an unsecured, subordinated loan that carries a relatively high contractual fixed interest rate generally ranging from 12% to 18%, to provide interest income. The loans generally have interest-only payments in the early years and payments of both principal and interest in the later years, with maturities of five to ten years. The debt instruments also have restrictive covenants that protect our interests in the transaction. Approximately 98% of the loans and debt securities in the private finance portfolio have fixed rates of interest. Our private finance mezzanine investments may include equity features, such as warrants or options to buy a minority interest in the portfolio company. The warrants we receive with our debt securities generally require only a minimal cost to exercise, and thus as the portfolio company appreciates in value, we achieve additional investment return from this equity interest. We seek to achieve additional investment returns of up to 10% from the appreciation and sale of our warrants. We target a total return of 18% to 25% for our private finance mezzanine investments. The typical private finance structure focuses, first, on the protection of our investment principal and then on investment return.

Generally, our warrants expire five years after the related debt is repaid. The warrants typically include registration rights, which allow us to sell the securities if the portfolio company completes a public offering. In most cases, the warrants also have a put option that requires that the borrower repurchase our equity position after a specified period of time at a formula price or at its fair market value. Most of the gains we realize from our warrant portfolio arise as a result of the sale of the portfolio company to another business, or through a recapitalization. Historically, we have not been dependent on the public equity markets for the sale of our warrant positions. We may also acquire preferred or common equity in a company as a part of our private finance investing activities, particularly when we see a unique opportunity to profit from the growth of an emerging company. Preferred equity investments may be structured with a dividend yield, which would provide us with a current return. With respect to preferred or common equity investments, we target an investment return of 25% to 40%.

In addition to our private finance mezzanine investment activities, we may acquire more than 50% of the common stock of a company in a control buyout transaction. In addition to our common equity investment, we may also provide additional capital to the controlled portfolio company in the form of senior loans, subordinated debt or preferred stock. The types of companies that we would acquire through a control buyout transaction are the same types of companies that we would invest in through our other private finance

investing activities. In particular, we may see opportunities to acquire illiquid public companies and take them private. We intend to be selective about the companies in which we would acquire a controlling interest to ensure that we maintain a diversified portfolio with respect to industry types and geographic locations.

We generally structure our control investments such that we receive a current return through a combination of interest income on our senior loans and subordinated debt, dividends on our preferred and common stock, and management or transaction fees to compensate us for the managerial assistance that we provide to a portfolio company. For these types of investments, we target an overall investment return on control investments of 25% to 40%.

We fund new investments using cash, through the issuance of common equity, the reinvestment of previously accrued interest and dividends in debt and equity securities, or the current reinvestment of interest and dividend income through the receipt of a debt or equity security. From time to time, we may also opt to reinvest accrued interest receivable in a new debt or equity security, in lieu of receiving such interest in cash and funding a subsequent growth investment. When we acquire a controlling interest in a company, we may have the opportunity to acquire the company s equity with Allied Capital s common stock. The issuance of our stock as consideration provides us with the benefit of raising equity without having to access the public markets in an underwritten offering, including the added benefit of the elimination of any underwriter commissions.

As a BDC, we are required to make significant managerial assistance available to the companies in our investment portfolio. In addition to the interest and dividends received from our private finance investments, we will often generate additional fee income for the structuring, diligence, transaction and management services and guarantees we provide to our portfolio companies.

In addition to our primary private finance investment activity described above, since the second quarter of 2000 we have made commitments to invest in and strategically partner with select private equity funds focused on venture capital investments. In addition to the return we expect to achieve from these investments, we believe we can achieve strategic benefits from these funds, including technology expertise for private finance portfolio companies, co-investment opportunities and increased deal flow. We may make additional commitments to other such funds, but expect our total investment in this area to remain a small percentage of our total portfolio.

We hold a portion of our private finance investments in a wholly owned subsidiary, Allied Investment Corporation. Allied Investment is a BDC and is licensed and regulated by the Small Business Administration to operate as a small business investment company (SBIC). See Certain Government Regulations below for further information about SBIC regulation.

Commercial Real Estate Finance

Our commercial real estate investment activity is focused on the investment in non-investment grade commercial mortgage-backed securities (CMBS). As an investor, we believe that CMBS has attractive risk/return characteristics. The CMBS in which we invest are non-investment grade, which means that nationally recognized statistical rating organizations rate them below the top four investment-grade rating categories (i.e., AAA through BBB), and are sometimes referred to as junk bonds. Unlike most junk

bonds, which are typically unsecured debt instruments, the non-investment grade CMBS in which we invest are secured by commercial mortgage loans, which are, in turn, secured by commercial real estate. Our CMBS are fully collateralized by senior mortgage loans on commercial real estate properties where the loans, on average, were underwritten to achieve a loan to value ratio of 69.0%. We invest in CMBS on the initial issuance of the CMBS bond offering, and are able to underwrite and negotiate to acquire the securities at a significant discount from their face amount, generally resulting in an estimated yield to maturity ranging from 13% to 16%. We find the yields for CMBS attractive given their collateral protection.

We believe this risk/return dynamic exists in this market today because there are significant barriers to entry for a non-investment grade CMBS investor. First, non-investment grade CMBS are long-term investments and require long-term investment capital. Our capital structure, which is in excess of 50% equity capital, is well suited for this asset class. Second, when we purchase CMBS in an initial issuance, we re-underwrite every mortgage loan in the underlying collateral pool, and we meet with the issuer to discuss the nature and type of loans we will accept into the pool. We have significant commercial mortgage loan underwriting expertise, both in terms of the number of professionals we employ and the depth of their commercial real estate experience. Access to this type of expertise is another barrier to entry into this market.

As a non-investment grade CMBS investor, we recognize that non-investment grade bonds have a higher degree of risk than do investment-grade bonds. Non-investment grade securities are considered speculative, and their capacity to pay principal and interest in accordance with the terms of their issue is not ensured. They tend to be less liquid, may have a higher risk of default, and may be more difficult to value. We invest in non-investment grade CMBS represented by the BB to non-rated tranches of a CMBS issuance. The non-investment grade CMBS bonds in which the Company invest are junior in priority for payment of principal to the more senior tranches of the related CMBS bond issuance. Cash flow from the underlying mortgages generally is allocated first to the senior tranches, with the most senior tranches having a priority right to the cash flow. Then, any remaining cash flow is allocated generally, among the other tranches in order of their relative seniority. To the extent there are defaults and unrecoverable losses on the underlying mortgages resulting in reduced cash flows, the Company s most subordinate tranch will bear this loss first. At December 31, 2001, the Company s CMBS bonds were subordinate to 91% to 97% of the tranches of various CMBS bond issuances.

To mitigate the risks associated with a CMBS investment discussed above, we perform extensive due diligence prior to each investment in CMBS. The underwriting procedures and criteria used to underwrite each of the commercial mortgage loans in each collateral pool are described in detail below. We will only invest in CMBS when we believe, as a result of our underwriting procedures, that the underlying mortgage pool adequately secures our position. Our portfolio of C