ALLIED CAPITAL CORP
Form 10-Q
May 15, 2001

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FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

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

FOR THE QUARTERLY PERIOD
ENDED MARCH 31, 2001
COMMISSION FILE NUMBER:
0-22832

ALLIED CAPITAL CORPORATION

(Exact Name of Registrant as Specified in its Charter)

MARYLAND
(State or Jurisdiction of
Incorporation or Organization)
52-1081052
(IRS Employer
Identification No.)

1919 PENNSYLVANIA AVENUE, N.W.
WASHINGTON, DC 20006
(Address of Principal Executive Offices)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (202) 331-1112

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 12 of 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter periods as the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES [X] NO [ ]

On May 15, 2001 there were 91,391,506 shares outstanding of the Registrant's common stock, $0.0001 par value.

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ALLIED CAPITAL CORPORATION

FORM 10-Q INDEX

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PART I: FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET

(IN THOUSANDS, EXCEPT NUMBER OF SHARE AMOUNTS)	MARCH 31, 2001 (UNAUDITED)	DECEMBER 31, 2000
ASSETS		
Portfolio at value:		
Private finance (cost: 2001-$1,272,863; 2000-$1,262,529)	$1,303,288	$1,282,467
Commercial real estate finance (cost: 2001-$579,882; 2000-$503,366)......................................	583,465	505,534
Total portfolio at value.........................	1,886,753	1,788,001

Cash and cash equivalents	9,392	2,449
Other assets	77,353	63,367
Total assets	$1,973,498	$1,853,817

LIABILITIES AND SHAREHOLDERS' EQUITY

Liabilities:		
Notes payable and debentures	$ 715,276	$ 704,648
Revolving credit facilities	168,500	82,000
Accounts payable and other liabilities	28,477	30,477
Total liabilities	912,253	817,125
Commitments and Contingencies		
Preferred stock	7,000	7,000
Shareholders' equity:		
Common stock, $0.0001 par value, 200,000,000 shares authorized; 85,956,072 and 85,291,696 shares issued and outstanding at March 31, 2001 and December 31, 2000, respectively	9	9
Additional paid-in capital	1,058,293	1,043,653
Notes receivable from sale of common stock	(25,062)	(25,083)
Net unrealized appreciation on portfolio	30,525	19,378
Distributions in excess of earnings	(9,520)	(8,265)
Total shareholders' equity	1,054,245	1,029,692
Total liabilities and shareholders' equity	$1,973,498	$1,853,817

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

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ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF OPERATIONS

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)	FOR THE THREE MONTHS ENDED MARCH 31, 2001	2000
	(UNAUDITED)	
Interest and related portfolio income:		
Interest and dividends	$54,875	$38,812
Premiums from loan dispositions	821	3,289
Investment advisory fees and other income	9,375	1,796
Total interest and related portfolio income	65,071	43,897
Expenses:		
Interest	15,930	12,311
Employee	6,418	4,569

Administrative	2,967	2,753
Total operating expenses	25,315	19,633
Formula and cut-off awards	28	1,691
Net operating income before net realized and unrealized gains	39,728	22,573
Net realized and unrealized gains:		
Net realized gains	1,154	2,176
Net unrealized gains	11,146	4,832
Total net realized and unrealized gains	12,300	7,008
Net increase in net assets resulting from operations	$52,028	$29,581
Basic earnings per common share	$ 0.61	$ 0.45
Diluted earnings per common share	$ 0.60	$ 0.45
Weighted average common shares outstanding -- basic	85,504	66,289
Weighted average common shares outstanding -- diluted	87,059	66,308

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN NET ASSETS

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)	FOR THE THREE MONTHS ENDED MARCH 31, 2001	2000
	(UNAUDITED)	
Operations:		
Net operating income before realized and unrealized gains	$ 39,728	$ 22,573
Net realized gains	1,154	2,176
Net unrealized gains	11,146	4,832
Net increase in net assets resulting from operations	52,028	29,581
Shareholder distributions:		
Common stock dividends	(42,081)	(30,716)
Preferred stock dividends	(55)	(55)
Net decrease in net assets resulting from		

shareholder distributions	(42,136)	(30,771)
Capital share transactions:		
Sale of common stock	9,950	42,246
Issuance of common stock upon the exercise of stock options	2,904	1,101
Issuance of common stock in lieu of cash distributions	1,785	1,237
Net decrease (increase) in notes receivable from sale of common stock	22	(842)
Net decrease in common stock held in deferred compensation trust	--	1,845
Other	--	(370)
Net increase in net assets resulting from capital share transactions	14,661	45,217
Total increase in net assets	$ 24,553	$ 44,027
Net assets at beginning of period	$1,029,692	$667,513
Net assets at end of period	$1,054,245	$711,540
Net asset value per common share	$ 12.26	$ 10.44
Common shares outstanding at end of period	85,956	68,163

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOWS

	FOR THE THREE MONTHS ENDED MARCH 31,	
(IN THOUSANDS)	2001	2000
	(UNAUDITED)	
Cash flows from operating activities:		
Net increase in net assets resulting from operations	$ 52,028	$ 29,581
Adjustments		
Net unrealized gains	(11,146)	(4,832)
Depreciation and amortization	257	202
Amortization of loan discounts and fees	(2,668)	(3,120)
Changes in other assets and liabilities	(4,076)	(3,661)
Net cash provided by operating activities	34,395	18,170
Cash flows from investing activities:		
Portfolio investments	(160,080)	(218,308)
Repayments of investment principal	31,027	53,431
Proceeds from loan sales	35,187	39,628

Other investing activities	(3,239)	(1,891)
Net cash used in investing activities	(97,105)	(127,140)
Cash flows from financing activities:		
Sale of common stock	9,950	42,246
Collections of notes receivable from sale of common stock	1,501	229
Common dividends and distributions paid	(40,296)	(29,479)
Preferred stock dividends paid	(55)	(55)
Net borrowings under notes payable and debentures	10,628	12,000
Net borrowings under revolving lines of credit	86,500	78,500
Other financing activities	1,425	180
Net cash provided by financing activities	69,653	103,621
Net increase (decrease) in cash and cash equivalents	$ 6,943	$ (5,349)
Cash and cash equivalents at beginning of period	$ 2,449	$ 18,155
Cash and cash equivalents at end of period	$ 9,392	$ 12,806

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ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF INVESTMENTS

PRIVATE FINANCE PORTFOLIO COMPANY (IN THOUSANDS, EXCEPT NUMBER OF SHARES)	INVESTMENT(2)	MARCH (UN COST
Ability One Corporation	Loans	$ 10,14
ACE Products, Inc.	Loans	14,50
Acme Paging, L.P.	Debt Securities	6,98
	Limited Partnership Interest	1,45
Allied Office Products, Inc.	Debt Securities	9,37
	Warrants	62
American Barbecue & Grill, Inc.	Warrants	12
American Home Care Supply, LLC	Debt Securities	6,86
	Warrants	57
Aspen Pet Products, Inc.	Loans	13,91
	Series A Preferred Stock (1,860 shares)	1,86
	Series A Common Stock (1,400 shares)	14
ASW Holding Corporation	Warrants	2

Aurora Communications, LLC	Loans	14,99
	Equity Interest	1,50
Avborne, Inc.	Debt Securities	12,11
	Warrants	1,18
Bakery Chef, Inc.	Loans	16,16
Border Foods, Inc.	Debt Securities	9,26
	Series A Convertible Preferred Stock (50,919 shares)	2,00
	Warrants	66
Business Loan Express, Inc.	Debt Securities	66,00
	Preferred Stock (25,111 shares)	25,11
	Common Stock (25,503,043 shares)	104,50
	Guaranty ($37.7 million -- See Note 3)	-
Camden Partners Strategic Fund II, L.P.	Limited Partnership Interest	61
CampGroup, LLC	Debt Securities	2,60
	Warrants	22
Candlewood Hotel Company(1)	Preferred Stock (3,250 shares)	3,25
Celebrities, Inc.	Loan	26
	Warrants	1
Colibri Holding Corporation	Loans	3,44
	Common Stock (3,362 shares)	1,25
	Warrants	29
Component Hardware Group, Inc.	Debt Securities	10,41
	Class A Preferred Stock (18,000 shares)	1,80
	Common Stock (2,000 shares)	20

(1) Public company.
(2) Common stock, preferred stock, warrants, options and equity interests are generally non-income producing and restricted.

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

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PRIVATE FINANCE PORTFOLIO COMPANY (IN THOUSANDS, EXCEPT NUMBER OF SHARES)	INVESTMENT(2)	MARCH (UN COST
Convenience Corporation of America	Debt Securities	$ 8,35
	Series A Preferred Stock (31,521 shares)	33
	Warrants	-
Cooper Natural Resources, Inc.	Debt Securities	3,72

	Warrants	-
CorrFlex Graphics, LLC	Loan	6,95
	Debt Securities	4,95
	Warrants	-
	Options	-
Cosmetic Manufacturing Resources, LLC	Loan	12
	Debt Securities	5,85
	Options	8
Coverall North America, Inc.	Loan	9,69
	Debt Securities	4,96
	Warrants	-
Csabai Canning Factory Rt.	Hungarian Quotas (9.2%)	70
CTT Holdings	Loan	1,26
CyberRep	Loan	1,00
	Debt Securities	11,01
	Warrants	66
Directory Investment Corporation	Common Stock (470 shares)	10
Directory Lending Corporation	Series A Common Stock (34 shares)	-
	Series B Common Stock (6 shares)	
	Series C Common Stock (10 shares)	2
Drilltec Patents & Technologies Company, Inc.	Loan	10,91
	Debt Securities	1,50
	Warrants	-
eCentury Capital Partners, L.P.	Limited Partnership Interest	1,87
EDM Consulting, LLC	Debt Securities	1,87
	Common Stock (100 shares)	25
El Dorado Communications, Inc.	Loans	30
Elexis Beta GmbH	Options	42
Eparfin S.A.	Loan	2
Esquire Communications Ltd.(1)	Warrants	
E-Talk Corporation	Debt Securities	8,84
	Warrants	1,15
ExTerra Credit Recovery, Inc.	Series A Preferred Stock (500 shares)	59
	Common Stock (2,500 shares)	-
	Warrants	-
Executive Greetings, Inc.	Debt Securities	15,89
	Warrants	36
Fairchild Industrial Products Company	Debt Securities	5,82
	Warrants	28
FTI Consulting, Inc.(1)	Warrants	97

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PRIVATE FINANCE PORTFOLIO COMPANY (IN THOUSANDS, EXCEPT NUMBER OF SHARES)	INVESTMENT(2)	MARCH (UN COST
Galaxy American Communications, LLC	Loan	$ 33,94
	Debt Securities	4,25
	Options	-
Garden Ridge Corporation	Debt Securities	26,53
	Preferred Stock (1,130 shares)	1,13
	Common Stock (471 shares)	61
Genesis Worldwide, Inc.(1)	Loan	1,06
Gibson Guitar Corporation	Debt Securities	16,62
	Warrants	52
Ginsey Industries, Inc.	Loans	5,00
	Convertible Debentures	50
	Warrants	-
Global Communications, LLC	Debt Securities	13,42
	Equity Interest	10,46
	Options	1,63
Global Vacation Group, Inc.(1)	Debt Securities	5,86
Grant Broadcasting Systems II	Warrants	8
Grant Television, Inc.	Equity Interest	66
Grotech Partners, VI, L.P.	Limited Partnership Interest	1,17
The Hartz Mountain Corporation	Debt Securities	27,23
	Common Stock (200,000 shares)	2,00
	Warrants	2,61
HealthASPex, Inc.	Series A Convertible Preferred Stock (622,020 shares)	3,00
	Series A Preferred Stock (414,680 shares)	76
	Common Stock (1,036,700 shares)	-
	Warrants	30
HMT, Inc.	Debt Securities	9,95
	Common Stock (300,000 shares)	3,00

	Warrants	-
Hotelevision, Inc.	Preferred Stock (315,100 shares)	31
Icon International, Inc.	Class A Common Stock (12,114 shares)	1,14
	Class C Common Stock (25,707 shares)	7
Impact Innovations Group	Debt Securities	6,42
	Warrants	1,67
Intellirisk Management Corporation	Loans	21,56
International Fiber Corporation	Debt Securities	21,78
	Common Stock (1,029,068 shares)	5,48
	Warrants	55
iSolve Incorporated	Series A Preferred Stock (14,853 shares)	87
	Common Stock (13,306 shares)	1
Jakel, Inc.	Loan	19,40

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PRIVATE FINANCE PORTFOLIO COMPANY (IN THOUSANDS, EXCEPT NUMBER OF SHARES)	INVESTMENT(2)	MARCH (UN COST
JRI Industries, Inc.	Debt Securities	$ 1,95
	Warrants	7
Julius Koch USA, Inc.	Debt Securities	1,98
	Warrants	25
Kirker Enterprises, Inc.	Warrants	34
	Equity Interest	
Kirkland's, Inc.	Debt Securities	6,35
	Preferred Stock (917 shares)	41
	Warrants	9
Kyrus Corporation	Debt Securities	7,75
	Warrants	34
Liberty-Pittsburgh Systems, Inc.	Debt Securities	4,22
	Common Stock (64,535 shares)	14
The Loewen Group, Inc.(1)	High-Yield Senior Secured Debt	15,15

Logic Bay Corporation	Preferred Stock (1,131,222 shares)	5,00
Love Funding Corporation	Series D Preferred Stock (26,000 shares)	 35
MagnaCard, Inc.	Debt Securities Preferred Stock (1,875 shares) Common Stock (4,687 shares)	15 9 -
Master Plan, Inc.	Loan Common Stock (156 shares)	2,00 4
MedAssets.com, Inc.	Series B Convertible Preferred Stock (227,665 shares) Warrants	 2,04 13
Mid-Atlantic Venture Fund IV, L.P.	Limited Partnership Interest	2,47
Midview Associates, L.P.	Warrants	-
Monitoring Solutions, Inc.	Debt Securities Common Stock (33,333 shares) Warrants	1,82 - -
MortgageRamp.com, Inc.	Class A Common Stock (800,000 shares)	4,00
Morton Grove Pharmaceuticals, Inc.	Loan Redeemable Convertible Preferred Stock (106,947 shares)	15,55 5,00
MVL Group	Debt Securities Warrants	14,15 64
NETtel Communications, Inc.	Debt Securities	13,48
Nobel Learning Communities, Inc.(1)	Debt Securities Series D Convertible Preferred Stock (265,957 shares) Warrants	9,59 2,00 57
North American Archery, LLC	Loans Convertible Debentures	1,39 2,24

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PRIVATE FINANCE PORTFOLIO COMPANY (IN THOUSANDS, EXCEPT NUMBER OF SHARES)	INVESTMENT(2)	MARCH (UN COST

Northeast Broadcasting Group, L.P.	Debt Securities	$ 34
Nursefinders, Inc.	Debt Securities	11,02
	Warrants	90
Onyx Television GmbH	Common Stock (600,000 shares)	20
Opinion Research Corporation(1)	Debt Securities	14,06
	Warrants	99
Oriental Trading Company, Inc.	Loan	12
	Debt Securities	12,52
	Preferred Equity Interest	1,48
	Common Equity Interest	1
	Warrants	-
Outsource Partners, Inc.	Debt Securities	23,86
	Warrants	82
Packaging Advantage Corporation	Debt Securities	11,51
	Common Stock (200,000 shares)	2,00
	Warrants	96
Physicians Specialty Corporation	Debt Securities	15,09
	Redeemable Preferred Stock (850 shares)	85
	Convertible Preferred Stock (97,411 shares)	15
	Warrants	47
Pico Products, Inc.(1)	Loan	1,30
	Debt Securities	4,59
	Common Stock (208,000 shares)	5
	Warrants	-
Polaris Pool Systems, Inc.	Debt Securities	6,50
	Warrants	1,05
Powell Plant Farms, Inc.	Loan	16,12
Proeducation GmbH	Loan	4
Professional Paint, Inc.	Debt Securities	20,75
	Preferred Stock (15,000 shares)	15,00
	Common Stock (110,000 shares)	6
Progressive International Corporation	Debt Securities	3,95
	Preferred Stock (500 shares)	50
	Common Stock (197 shares)	1
	Warrants	-
Redox Brands, Inc.	Debt Securities	9,85
	Warrants	-
Schwinn Holdings Corporation	Debt Securities	10,47
	Warrants	39
Seasonal Expressions, Inc.	Series A Preferred Stock (1,000 shares)	50

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PRIVATE FINANCE PORTFOLIO COMPANY (IN THOUSANDS, EXCEPT NUMBER OF SHARES)	INVESTMENT(2)	MARCH (UN COST
Soff-Cut Holdings, Inc.	Debt Securities	$ 8,35
	Preferred Stock (300 shares)	30
	Common Stock (2,000 shares)	20
	Warrants	44
Southern Communications, LLC	Equity Interest	9,77
Southwest PCS, LLC	Loan	7,69
Spa Lending Corporation	Preferred Stock (28,625 shares)	53
	Common Stock (6,208 shares)	2
Staffing Partners Holding Company, Inc.	Debt Securities	4,99
	Series A Redeemable Preferred Stock (414,600 shares)	2,07
	Class A1 Common Stock (1,000 shares)	
	Class A2 Common Stock (40,000 shares)	4
	Class B Common Stock (9,200 shares)	
	Warrants	1
Startec Global Communications, Corporation(1)	Debt Securities	20,21
	Common Stock (258,064 shares)	3,00
	Warrants	-
Sunsource Inc.(1)	Debt Securities	29,41
	Warrants	45
SunStates Refrigerated Services, Inc.	Loans	6,06
	Debt Securities	2,44
Sure-Tel, Inc.	Loan	20
	Preferred Stock (1,116,902 shares)	4,58
	Warrants	66
	Options	-
Sydran Food Services II, L.P.	Debt Securities	12,97
The Debt Exchange, Inc.	Series B convertible Preferred Stock (921,829 shares)	1,25
Total Foam, Inc.	Debt Securities	26

	Common Stock (910 shares)	1
Tubbs Snowshoe Company, LLC	Debt Securities	3,90
	Warrants	5
	Equity Interests	50
United Pet Group, Inc.	Debt Securities	4,96
	Warrants	1
Updata Venture Partners, II, L.P.	Limited Partnership Interest	1,30
Velocita, Inc.	Debt Securities	11,56
	Warrants	3,54
Venturehouse Group, LLC	Common Equity Interest	33
Walker Investment Fund II, LLLP	Limited Partnership Interest	80
Warn Industries, Inc.	Debt Securities	18,60
	Warrants	1,42

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PRIVATE FINANCE PORTFOLIO COMPANY (IN THOUSANDS, EXCEPT NUMBER OF SHARES)	INVESTMENT(2)	MARCH (UN COST
Williams Brothers Lumber Company	Warrants	$ 2
Wilmar Industries, Inc.	Debt Securities	31,75
	Warrants	3,16
Wilshire Restaurant Group, Inc.	Debt Securities	15,23
	Warrants	-
Wilton Industries, Inc.	Loan	12,83
Woodstream Corporation	Debt Securities	7,60
	Equity Interests	1,70
	Warrants	45
Wyo-Tech Acquisition Corporation	Debt Securities	15,68
	Preferred Stock (100 shares)	3,70
	Common Stock (99 shares)	10
Total private finance (124 investments)		$1,272,86

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(IN THOUSANDS, EXCEPT NUMBER OF LOANS)	INTEREST RATE RANGES	NUMBER OF LOANS	MARCH 31, 2001 (UNAUDITED) COST	VALUE
COMMERCIAL REAL ESTATE FINANCE				
Commercial Mortgage Loans	Up to 6.99%	3	$ 885	$ 2,585
	7.00%- 8.99%	12	29,933	32,033
	9.00%-10.99%	26	26,670	27,208
	11.00%-12.99%	30	24,249	24,368
	13.00%-14.99%	9	13,229	13,229
	15.00% and above	2	96	73
Total commercial mortgage loans		82	$95,062	$99,496

	STATED INTEREST	FACE		
Purchased CMBS				
Mortgage Capital Funding, Series 1998-MC3	5.5%	$ 54,491	$ 25,987	$ 25,98
Morgan Stanley Capital I, Series 1999-RM1	6.4%	51,046	21,404	21,40
COMM 1999-1	5.6%	74,879	34,466	34,46
Morgan Stanley Capital I, Series 1999-FNV1	6.1%	45,536	21,978	21,97
DLJ Commercial Mortgage Trust 1999-CG2	6.1%	96,432	44,508	44,50
Commercial Mortgage Acceptance Corp., Series 1999-C1	6.8%	34,856	16,419	16,41
LB Commercial Mortgage Trust, Series 1999-C2	6.7%	29,005	11,027	11,02
Chase Commercial Mortgage Securities Corp., Series 1999-2	6.5%	43,046	20,531	20,53
FUNB CMT, Series 1999-C4	6.5%	49,287	22,738	22,98
Heller Financial, HFCMC Series 2000 PH-1	6.6%	45,456	18,745	18,74
SBMS VII, Inc., Series 2000-NL1	7.2%	24,230	13,327	13,32
DLJ Commercial Mortgage Trust, Series 2000-CF1	7.0%	40,502	19,279	19,27
Deutsche Bank Alex. Brown, Series Comm 2000-C1	6.9%	41,084	19,267	19,26
LB-UBS Commercial Mortgage Trust, Series 2000-C4	6.9%	31,471	11,555	11,55
Credit Suisse First Boston Mortgage Securities Corp., Series 2001-CK1......................	5.9%	58,786	28,627	28,62
Crest 2001-1, Ltd. (collateralized debt obligation)................................	0.0%	24,625	24,811	24,81
JP Morgan-CIBC-Deutsche 2001....................	5.8%	90,065	51,450	51,67

Total purchased CMBS	$834,797	$ 406,119	$ 406,59
Residual CMBS		$ 72,850	$ 72,85
Residual Interest Spread		2,823	2,52
Real Estate Owned		3,028	2,00
Total commercial real estate finance		$ 579,882	$ 583,46
Total portfolio		$1,852,745	$1,886,75

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF INVESTMENTS

PRIVATE FINANCE PORTFOLIO COMPANY (IN THOUSANDS, EXCEPT NUMBER OF SHARES)	INVESTMENT(2)	DECEMB COST
Ability One Corporation	Loans	$ 9,97
ACE Products, Inc.	Loans	14,27
Acme Paging, L.P.	Debt Securities	6,98
	Limited Partnership Interest	1,45
Allied Office Products, Inc.	Debt Securities	9,36
	Warrants	62
American Barbecue & Grill, Inc.	Warrants	12
American Home Care Supply, LLC	Debt Securities	6,85
	Warrants	57
Aspen Pet Products, Inc.	Loans	13,86
	Series A Preferred Stock (1,860 shares)	1,86
	Series A Common Stock (1,400 shares)	14
ASW Holding Corporation	Warrants	2
Aurora Communications, LLC	Loans	14,41
	Equity Interest	1,50
Avborne, Inc.	Debt Securities	12,25
	Warrants	1,18
Bakery Chef, Inc.	Loans	15,89
Border Foods, Inc.	Debt Securities	9,90
	Series A Convertible Preferred Stock (50,919 shares)	2,00
	Warrants	-

Business Loan Express, Inc.	Debt Securities	74,46
	Preferred Stock (25,111 shares)	25,11
	Common Stock (25,503,043 shares)	104,50
Camden Partners Strategic Fund II, L.P.	Limited Partnership Interest	61
CampGroup, LLC	Debt Securities	2,57
	Warrants	22
Candlewood Hotel Company(1)	Preferred Stock (3,250 shares)	3,25
Celebrities, Inc.	Loan	27
	Warrants	1
Colibri Holding Corporation	Loans	3,43
	Common Stock (3,362 shares)	1,25
	Warrants	29
Component Hardware Group	Debt Securities	10,30
	Class A Preferred Stock (18,000 shares)	1,80
	Common Stock (2,000 shares)	20
Convenience Corporation of America	Debt Securities	8,35
	Series A Preferred Stock (31,521 shares)	33
	Warrants	-

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PRIVATE FINANCE PORTFOLIO COMPANY (IN THOUSANDS, EXCEPT NUMBER OF SHARES)	INVESTMENT(2)	DECEMB COST
Cooper Natural Resources, Inc.	Debt Securities	$ 3,42
	Warrants	-
CorrFlex Graphics, LLC	Loan	6,95
	Debt Securities	4,95
	Warrants	-
	Options	-
Cosmetic Manufacturing Resources, LLC	Loan	12
	Debt Securities	5,84
	Options	8
Coverall North America, Inc.	Loan	9,69
	Debt Securities	4,96

	Warrants	-
Csabai Canning Factory Rt.	Hungarian Quotas (9.2%)	70
CTT Holdings	Loan	1,22
CyberRep.coM	Loan	94
	Debt Securities	10,29
	Warrants	66
Directory Investment Corporation	Common Stock (470 shares)	10
Directory Lending Corporation	Series A Common Stock (34 shares)	-
	Series B Common Stock (6 shares)	
	Series C Common Stock (10 shares)	2
Drilltec Patents & Technologies Company, Inc.	Loan	10,91
	Debt Securities	1,50
	Warrants	-
eCentury Capital Partners, L.P.	Limited Partnership Interest	1,87
EDM Consulting, LLC	Debt Securities	1,87
	Common Stock (100 shares)	25
El Dorado Communications, Inc.	Loans	30
Elexis Beta GmbH	Options	42
Eparfin S.A.	Loan	2
Esquire Communications Ltd.(1)	Warrants	
E-Talk Corporation	Debt Securities	8,80
	Warrants	1,15
Ex Terra Credit Recovery, Inc.	Series A Preferred Stock (500 shares)	59
	Common Stock (2,500 shares)	-
	Warrants	-
Executive Greetings, Inc.	Debt Securities	15,88
	Warrants	36
Fairchild Industrial Products Company	Debt Securities	5,81
	Warrants	28
FTI Consulting, Inc.(1)	Warrants	97
Galaxy American Communications, LLC	Debt Securities	33,39
	Warrants	50

(1) Public company.
(2) Common stock, preferred stock, warrants, options and equity interests are generally non-incom producing and restricted.

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

PRIVATE FINANCE PORTFOLIO COMPANY (IN THOUSANDS, EXCEPT NUMBER OF SHARES)	INVESTMENT(2)	DECEMB COST
Garden Ridge Corporation	Debt Securities	$ 26,53
	Preferred Stock (1,130 shares)	1,13
	Common Stock (471 shares)	61
Genesis Worldwide, Inc.(1)	Loan	1,06
Gibson Guitar Corporation	Debt Securities	16,44
	Warrants	52
Ginsey Industries, Inc.	Loans	5,00
	Convertible Debentures	50
	Warrants	-
Global Communications, LLC	Debt Securities	12,73
	Equity Interest	10,46
	Options	1,63
Global Vacation Group, Inc.(1)	Debt Securities	5,68
Grant Broadcasting Systems II	Warrants	8
Grant Television, Inc.	Equity Interest	66
Grotech Partners, VI, L.P.	Limited Partnership Interest	86
The Hartz Mountain Corporation	Debt Securities	27,16
	Common Stock (200,000 shares)	2,00
	Warrants	2,61
HealthASPex, Inc.	Series A Convertible Preferred Stock (396,908 shares)	1,34
	Series A Preferred Stock (225,112 shares)	76
	Common Stock (1,036,700 shares)	-
HMT, Inc.	Debt Securities	9,95
	Common Stock (300,000 shares)	3,00
	Warrants	-
Hotelevision, Inc.	Preferred Stock (315,100 shares)	31
Icon International, Inc.	Class A Common Stock (12,114 shares)	1,14
	Class C Common Stock (25,707 shares)	7
Impact Innovations Group	Debt Securities	6,36
	Warrants	1,67
Intellirisk Management Corporation	Loans	21,44
International Fiber Corporation	Debt Securities	21,62
	Common Stock (1,029,068 shares)	5,48

	Warrants	55
iSolve Incorporated	Series A Preferred Stock (14,853 shares)	87
	Common Stock (13,306 shares)	1
Jakel, Inc.	Loan	19,23
JRI Industries, Inc.	Debt Securities	1,95
	Warrants	7

(1) Public company.
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PRIVATE FINANCE PORTFOLIO COMPANY (IN THOUSANDS, EXCEPT NUMBER OF SHARES)	INVESTMENT(2)	DECEMB COST
Julius Koch USA, Inc.	Debt Securities	$ 2,29
	Warrants	25
Kirker Enterprises, Inc.	Warrants	34
	Equity Interest	
Kirkland's, Inc.	Debt Securities	6,34
	Preferred Stock (917 shares)	41
	Warrants	9
Kyrus Corporation	Debt Securities	7,73
	Warrants	34
Liberty-Pittsburgh Systems, Inc.	Debt Securities	3,47
	Common Stock (64,535 shares)	14
The Loewen Group, Inc.(1)	High-Yield Senior Secured Debt	15,15
Logic Bay Corporation	Preferred Stock (1,131,222 shares)	5,00
Love Funding Corporation	Series D Preferred Stock (26,000 shares)	35
Master Plan, Inc.	Loan	2,00
	Common Stock (156 shares)	4
MedAssets.com, Inc.	Series B Convertible Preferred Stock (227,665 shares)	2,04
	Warrants	13

Mid-Atlantic Venture Fund IV, L.P.	Limited Partnership Interest	2,47
Midview Associates, L.P.	Warrants	-
Monitoring Solutions, Inc.	Debt Securities	1,82
	Common Stock (33,333 shares)	-
	Warrants	-
MortgageRamp.com, Inc.	Class A Common Stock (800,000 shares)	4,00
Morton Grove Pharmaceuticals, Inc.	Loan	15,35
	Redeemable Convertible Preferred Stock (106,947 shares)	5,00
MVL Group	Debt Securities	14,12
	Warrants	64
NETtel Communications, Inc.	Debt Securities	13,47
Nobel Learning Communities, Inc.(1)	Debt Securities	9,57
	Series D Convertible Preferred Stock (265,957 shares)	2,00
	Warrants	57
North American Archery, LLC	Loans	1,39
	Convertible Debentures	2,24
Northeast Broadcasting Group, L.P.	Debt Securities	34
Nursefinders, Inc.	Debt Securities	11,00
	Warrants	90

(1) Public company.
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The accompanying notes are an integral part of these consolidated financial statements.

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PRIVATE FINANCE PORTFOLIO COMPANY (IN THOUSANDS, EXCEPT NUMBER OF SHARES)	INVESTMENT(2)	DECEMB COST
Old Mill Holdings, Inc.	Debt Securities	$ 14
Onyx Television GmbH	Common Stock (600,000 shares)	20
Opinion Research Corporation(1)	Debt Securities	14,03
	Warrants	99
Oriental Trading Company, Inc.	Debt Securities	12,45

	Loan	12
	Preferred Equity Interest	1,48
	Common Equity Interest	1
	Warrants	-
Outsource Partners, Inc.	Debt Securities	23,85
	Warrants	82
Packaging Advantage Corporation	Debt Securities	11,49
	Common Stock (200,000 shares)	2,00
	Warrants	96
Physicians Specialty Corporation	Debt Securities	14,80
	Redeemable Preferred Stock (850 shares)	85
	Convertible Preferred Stock (97,411 shares)	15
	Warrants	47
Pico Products, Inc.(1)	Loan	1,30
	Debt Securities	4,59
	Common Stock (208,000 shares)	5
	Warrants	-
Polaris Pool Systems, Inc.	Debt Securities	6,48
	Warrants	1,05
Powell Plant Farms, Inc.	Loan	15,70
Proeducation GmbH	Loan	4
Professional Paint, Inc.	Debt Securities	20,00
	Preferred Stock (15,000 shares)	15,00
	Common Stock (110,000 shares)	6
Progressive International Corporation	Debt Securities	3,94
	Preferred Stock (500 shares)	50
	Common Stock (197 shares)	1
	Warrants	-
Schwinn Holdings Corporation	Debt Securities	10,36
	Warrants	39
Seasonal Expressions, Inc.	Series A Preferred Stock (1,000 shares)	50
Soff-Cut Holdings, Inc.	Debt Securities	8,45
	Preferred Stock (300 shares)	30
	Common Stock (2,000 shares)	20
	Warrants	44
Southern Communications, LLC	Equity Interest	9,77

(1) Public company.
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The accompanying notes are an integral part of these consolidated financial statements.

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PRIVATE FINANCE PORTFOLIO COMPANY (IN THOUSANDS, EXCEPT NUMBER OF SHARES)	INVESTMENT(2)	DECEMB COST
Southwest PCS, LLC	Loan	$ 7,50
Southwest PCS, L.P.	Debt Securities	6,51
Spa Lending Corporation	Preferred Stock (28,625 shares)	54
	Common Stock (6,208 shares)	2
Staffing Partners Holding Company, Inc.	Debt Securities	4,99
	Series A Redeemable Preferred Stock (414,600 shares)	2,07
	Class A1 Common Stock (1,000 shares)	
	Class A2 Common Stock (40,000 shares)	4
	Class B Common Stock (9,200 shares)	
	Warrants	1
Startec Global Communications, Corporation(1)	Debt Securities	20,20
	Common Stock (258,064 shares)	3,00
	Warrants	-
Sunsource Inc.(1)	Debt Securities	29,85
	Warrants	-
SunStates Refrigerated Services, Inc.	Loans	6,06
	Debt Securities	2,44
Sure-Tel, Inc.	Loan	20
	Preferred Stock (1,116,902 shares)	4,55
	Warrants	66
	Options	-
Sydran Food Services II, L.P.	Debt Securities	12,97
Total Foam, Inc.	Debt Securities	26
	Common Stock (910 shares)	1
Tubbs Snowshoe Company, LLC	Debt Securities	3,89
	Warrants	5
	Equity Interests	50
United Pet Group	Debt Securities	4,95
	Warrants	1
Velocita, Inc.	Debt Securities	11,53
	Warrants	3,54
Venturehouse Group, LLC	Common Equity Interest	33
Walker Investment Fund II, LLLP	Limited Partnership Interest	80

Warn Industries, Inc.	Debt Securities	19,33
	Warrants	1,42
Williams Brothers Lumber Company	Warrants	2
Wilmar Industries, Inc.	Debt Securities	31,72
	Warrants	3,16
Wilshire Restaurant Group, Inc.	Debt Securities	15,19
	Warrants	-
Wilton Industries, Inc.	Loan	12,83

(1) Public company.
(2) Common stock, preferred stock, warrants, options and equity interests are generally non-incom producing and restricted.

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

PRIVATE FINANCE PORTFOLIO COMPANY (IN THOUSANDS, EXCEPT NUMBER OF SHARES)	INVESTMENT(2)	DECEMB COST
Woodstream Corporation	Debt Securities	$ 7,59
	Equity Interests	1,70
	Warrants	45
Wyo-Tech Acquisition Corporation	Debt Securities	15,67
	Preferred Stock (100 shares)	3,70
	Common Stock (99 shares)	10
Total private finance (122 investments)		$1,262,52

(1) Public company.
(2) Common stock, preferred stock, warrants, options and equity interests are generally non-incom producing and restricted.

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

(IN THOUSANDS, EXCEPT NUMBER OF LOANS)	INTEREST RATE RANGES	NUMBER OF LOANS	DECEMBER 31, 2000 COST	VALUE
COMMERCIAL REAL ESTATE FINANCE				
Commercial Mortgage Loans	Up to 6.99%	3	$ 882	$ 2,582
	7.00%- 8.99%	13	30,032	32,132
	9.00%-10.99%	17	22,302	22,190
	11.00%-12.99%	38	35,250	35,042
	13.00%-14.99%	12	14,391	14,391
	15.00% and above	2	100	76
Total commercial mortgage loans		85	$102,957	$106,413

	STATED INTEREST	FACE		
Purchased CMBS				
Mortgage Capital Funding, Series 1998-MC3	5.5%	$ 54,491	$ 25,681	$ 25,68
Morgan Stanley Capital I, Series 1999-RM1	6.4%	59,640	27,429	27,42
COMM 1999-1	5.6%	74,879	34,352	34,35
Morgan Stanley Capital I, Series 1999-FNV1	6.1%	45,536	21,972	21,97
DLJ Commercial Mortgage Trust 1999-CG2	6.1%	96,432	44,332	44,33
Commercial Mortgage Acceptance Corp., Series 1999-C1	6.8%	34,856	16,397	16,39
LB Commercial Mortgage Trust, Series 1999-C2	6.7%	29,005	10,910	10,91
Chase Commercial Mortgage Securities Corp., Series 1999-2	6.5%	43,046	20,552	20,55
FUNB CMT, Series 1999-C4	6.5%	49,287	22,515	22,76
Heller Financial, HFCMC Series 2000 PH-1	6.6%	45,456	19,039	19,03
SBMS VII, Inc., Series 2000-NL1	7.2%	30,079	17,820	18,00
DLJ Commercial Mortgage Trust, Series 2000-CF1	7.0%	40,502	19,166	19,16
Deutsche Bank Alex. Brown, Series Comm 2000-C1	6.9%	41,084	19,170	19,17
LB-UBS Commercial Mortgage Trust, Series 2000-C4	6.9%	31,471	11,552	11,55
Total purchased CMBS		$675,764	$ 310,887	$ 311,32
Residual CMBS			$ 78,723	$ 78,72
Residual Interest Spread			3,297	2,99
Real Estate Owned			7,502	6,08
Total commercial real estate finance			$ 503,366	$ 505,53
Total portfolio			$1,765,895	$1,788,00

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. ORGANIZATION

Allied Capital Corporation, a Maryland corporation, is a closed-end management investment company that has elected to be regulated as a business development company ("BDC") under the Investment Company Act of 1940 ("1940 Act"). Allied Capital Corporation ("ACC") has a wholly owned subsidiary that has also elected to be regulated as a BDC. Allied Investment Corporation ("Allied Investment") is licensed under the Small Business Investment Act of 1958 as a Small Business Investment Company ("SBIC"). In addition, the Company has a real estate investment trust subsidiary, Allied Capital REIT, Inc. ("Allied REIT") and several single-member limited liability companies established primarily to hold real estate properties.

ACC also owned Allied Capital SBLC Corporation ("Allied SBLC"), a BDC licensed by the Small Business Administration ("SBA") as a Small Business Lending Company and a participant in the SBA Section 7(a) Guaranteed Loan Program. On December 31, 2000, ACC acquired BLC Financial Services, Inc. as a private portfolio company, which then changed its name to Business Loan Express, Inc. ("BLX"). As a part of the transaction, Allied SBLC was recapitalized as an independently managed, private portfolio company on December 28, 2000 and ceased to be a consolidated subsidiary of the Company at that time. Allied SBLC was then subsequently merged into BLX. The results of the operations of Allied SBLC are included in the consolidated financial results of ACC and its subsidiaries for 2000 through December 27, 2000.

Allied Capital Corporation and its subsidiaries, collectively, are hereinafter referred to as the "Company."

The investment objective of the Company is to achieve current income and capital gains. In order to achieve this objective, the Company invests in private and undervalued public companies in a variety of different industries and in diverse geographic locations.

NOTE 2. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements of the Company have been prepared in accordance with generally accepted accounting principles ("GAAP") for interim financial information. Accordingly, they do not include all of the information and footnotes required by GAAP for complete consolidated financial statements. In the opinion of management, the unaudited consolidated financial results of the Company included herein contain all adjustments (consisting of only normal recurring accruals) necessary to present fairly the financial position of the Company as of and for the three months ended March 31, 2001 and 2000 and the results of operations, changes in net assets, and cash flows for these periods. The results of operations for the three months ended March 31, 2001 are not necessarily indicative of the operating results to be expected for the full year.

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation. Certain reclassifications have been made to the 2000 balances to conform with the 2001 financial statement presentation.

NOTE 3. PORTFOLIO

PRIVATE FINANCE

At March 31, 2001 and December 31, 2000, the private finance portfolio consisted of the following:

($ IN THOUSANDS)	2001 COST	2001 VALUE	2001 YIELD	2000 COST	2000 VALUE	2000 YIEL
Loans and debt securities......	$ 988,653	$ 959,466	14.7%	$ 983,887	$ 966,257	14.6
Equity interests...............	284,210	343,822		278,642	316,210	
Total................	$1,272,863	1,303,288		$1,262,529	$1,282,467	

Private finance investments are generally structured as loans and debt securities that carry a relatively high fixed rate of interest, which may be combined with equity features, such as conversion privileges, or warrants or options to purchase a portion of the portfolio company's equity at a nominal price.

Debt securities typically have a maturity of five to ten years, with interest-only payments in the early years and payments of both principal and interest in the later years, although debt maturities and principal amortization schedules vary.

Equity interests consist primarily of securities issued by privately owned companies and may be subject to restrictions on their resale or may be otherwise illiquid. Equity securities generally do not produce a current return, but are held for investment appreciation and ultimate gain on sale.

At March 31, 2001 and December 31, 2000, equity interests include the Company's common stock and preferred stock investment in Business Loan Express, Inc. ("BLX") of $120,004,000 and $25,111,000 and $104,504,000 and $25,111,000 at value, respectively. During the first quarter of 2001, BLX secured a 3-year $117.5 million unsecured revolving credit facility. As the controlling shareholder of BLX, the Company has provided an unconditional guaranty to the BLX credit facility lenders in an amount 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 March 31, 2001 was $37.7 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 its credit facility at March 31, 2001. In consideration for providing this guaranty, BLX will pay the Company an annual guaranty fee of $2.9 million.

At March 31, 2001 and December 31, 2000, approximately 98% of the Company's private finance loan portfolio was composed of fixed interest rate loans. At March 31, 2001 and December 31, 2000, loans and debt securities with a value of $81,050,000 and $72,966,000, respectively, were not accruing interest. Loans greater than 120 days delinquent generally do not accrue interest.

NOTE 3. PORTFOLIO, CONTINUED

The geographic and industry compositions of the private finance portfolio at value at March 31, 2001 and December 31, 2000 were as follows:

	2001	2000
GEOGRAPHIC REGION		
Mid-Atlantic	40%	43%
Midwest	22	18
West	17	17
Southeast	12	12
Northeast	8	8
International	1	2
Total	100%	100%
INDUSTRY		
Consumer Products	27%	26%
Business Services	24	24
Financial Services	16	16
Industrial Products	9	9
Retail	5	5
Broadcasting & Cable	5	5
Telecommunications	4	6
Education	4	3
Other	6	6
Total	100%	100%

COMMERCIAL REAL ESTATE FINANCE

At March 31, 2001 and December 31, 2000, the commercial real estate finance portfolio consisted of the following:

	2001			2000	
($ IN THOUSANDS)	COST	VALUE	YIELD	COST	VALUE
Loans	$ 95,062	$ 99,496	8.9%	$102,957	$106,413
CMBS	481,792	481,967	14.6%	392,907	393,040
REO	3,028	2,002		7,502	6,081
Total	$579,882	$583,465		$503,366	$505,534

LOANS

The commercial mortgage loan portfolio contains loans that were originated by the Company or were purchased from third-party sellers.

At March 31, 2001 and December 31, 2000, approximately 70% and 30% and 69% and 31% of the Company's commercial mortgage loan portfolio was composed of fixed and adjustable interest rate loans, respectively. As of March 31, 2001 and December 31, 2000, loans with a value of $12,440,000 and $14,433,000, respectively, were not accruing interest. Loans greater than 120 days delinquent generally do not accrue interest.

NOTE 3. PORTFOLIO, CONTINUED

In December 2000, the Company purchased commercial mortgage loans with a face amount of $6.5 million for $5.5 million from Business Mortgage Investors, Inc., a company managed by ACC.

The geographic composition and the property types securing the commercial mortgage loan portfolio at value at March 31, 2001 and December 31, 2000 were as follows:

	2001	2000
GEOGRAPHIC REGION		
Southeast	37%	39%
Midwest	18	14
Northeast	17	5
West	15	20
Mid-Atlantic	13	22
Total	100%	100%
PROPERTY TYPE		
Hospitality	32%	28%
Office	28	30
Retail	23	19
Recreation	3	9
Other	14	14
Total	100%	100%

CMBS

At March 31, 2001 and December 31, 2000, the CMBS portfolio consisted of the following:

	2001		2000	
(IN THOUSANDS)	COST	VALUE	COST	VALUE
Purchased CMBS	$406,119	$406,594	$310,887	$311,320
Residual CMBS	72,850	72,850	78,723	78,723
Residual interest spread	2,823	2,523	3,297	2,997

Total	$481,792	$481,967	$392,907	$393,040

PURCHASED CMBS The Company has Purchased CMBS bonds with a face amount of $834,797,000 and a cost of $406,119,000, with the difference representing original issue discount. As of March 31, 2001 and December 31, 2000, the estimated yield to maturity on the Purchased CMBS was approximately 15.6% and 15.4%, respectively. The Company's yield on its Purchased CMBS is based upon a number of assumptions that are subject to certain business and economic uncertainties and contingencies. Examples include the timing and magnitude of credit losses on the mortgage loans underlying the Purchased CMBS that are a result of the general condition of the real estate market (including competition for tenants and their related credit quality) and changes in market rental rates. At March 31, 2001 and December 31, 2000, the yield on the Purchased CMBS portfolio was computed assuming a 1% loss estimate for its entire underlying collateral mortgage pool. As these uncertainties and contingencies are difficult to predict and are subject to future events which may alter these assumptions, no assurance can be given that the anticipated yields to maturity will be achieved.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

NOTE 3. PORTFOLIO, CONTINUED

The non-investment grade and unrated tranches of the Purchased CMBS bonds are junior in priority for payment of principal to the more senior tranches of the related commercial securitization. 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 subordinate tranche will bear this loss first.

The Company entered into one short sale contract with a financial institution as part of a strategy to manage interest rate risk with respect to certain CMBS bonds. The Company used the short sale for hedging and risk management only and not for speculative purposes. At March 31, 2001, the fair value of the contract was $240,000. The fair value of this contract has been reflected in net unrealized gains. The Company held no derivative financial instruments at December 31, 2000.

The underlying rating classes of the Purchased CMBS at March 31, 2001 and December 31, 2000 are as follows:

	2001		2000	
($ IN THOUSANDS)	VALUE	PERCENTAGE OF TOTAL	VALUE	PERCENTA OF TOTA
BB+	$ 22,471	5.5%	$ --	--%
BB	19,523	4.8	8,472	2.7
BB-	41,315	10.2	37,061	11.9
B+	71,290	17.5	59,827	19.3

B	100,595	24.8	89,999	28.9
B-	60,994	15.0	56,665	18.2
CCC	7,748	1.9	7,857	2.5
Unrated	82,658	20.3	51,439	16.5
Total	$406,594	100.0%	$311,320	100.0%

RESIDUAL CMBS AND RESIDUAL INTEREST SPREAD. The Residual CMBS primarily consists of a retained interest from a post-Merger asset securitization whereby bonds were sold in three classes rated "AAA," "AA" and "A."

The Company sold $295 million of loans, and received cash proceeds, net of costs, of approximately $223 million. The Company retained a trust certificate for its residual interest in the loan pool sold, and will receive interest income from this Residual CMBS as well as the Residual Interest Spread from the interest earned on the loans sold less the interest paid on the bonds over the life of the bonds.

As a result of this securitization, the Company recorded a gain of $14.8 million, which represents the difference between the cost basis of the assets sold and the fair value of the assets received, net of the costs of the securitization and the cost of settlement of interest rate swaps. As of March 31, 2001 and December 31, 2000, the mortgage loan pool had an approximate weighted average stated interest rate of 9.3%. The three bond classes sold had an aggregate weighted average interest rate of 6.5% as of March 31, 2001 and December 31, 2000.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

NOTE 3. PORTFOLIO, CONTINUED

The Company uses a discounted cash flow methodology for determining the value of its retained Residual CMBS and Residual Interest Spread ("Residual"). In determining the cash flow of the Residual, the Company assumes a prepayment speed of 15% after the applicable prepayment lockout period and credit losses of 1% of the total principal balance of the underlying collateral throughout the life of the collateral. The value of the resulting Residual cash flows is then determined by applying a discount rate of 9% which, in the Company's view, is commensurate with the market's perception of risk of comparable assets.

The geographic composition and the property types of the underlying mortgage loan pools securing the CMBS calculated using the underwritten principal balance at March 31, 2001 and December 31, 2000 were as follows:

	2001	2000
GEOGRAPHIC REGION		
West	31%	31%
Mid-Atlantic	24	23
Midwest	22	22
Southeast	18	19
Northeast	5	5

Total	100%	100%
PROPERTY TYPE		
Retail	32%	32%
Housing	29	30
Office	23	21
Hospitality	7	8
Other	9	9
Total	100%	100%

SMALL BUSINESS FINANCE

The Company, through its wholly owned subsidiary, Allied SBLC, participated in the SBA's Section 7(a) Guaranteed Loan Program ("7(a) loans"). As discussed in Note 1, Allied SBLC is no longer a consolidated subsidiary of the Company at December 31, 2000. As a result, the Company's small business portfolio had no balance at December 31, 2000.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

NOTE 4. DEBT

At March 31, 2001 and December 31, 2000, the Company had the following debt:

	2001		2000	
(IN THOUSANDS)	FACILITY AMOUNT	AMOUNT DRAWN	FACILITY AMOUNT	AMOUNT DRAWN
Notes payable and debentures:				
Unsecured long-term notes payable	$ 544,000	$544,000	$ 544,000	$544,00
SBA debentures	108,800	87,350	87,350	78,35
Auction rate reset note	78,226	78,226	76,598	76,59
OPIC loan	5,700	5,700	5,700	5,70
Total notes payable and debentures	736,726	715,276	713,648	704,64
Revolving credit facilities:				
Revolving line of credit	417,500	168,500	417,500	82,00
Master loan and security agreement	--	--	--	-
Total revolving credit facilities	417,500	168,500	417,500	82,00
Total	$1,154,226	$883,776	$1,131,148	$786,64

NOTES PAYABLE AND DEBENTURES

UNSECURED LONG-TERM NOTES PAYABLE. In June 1998, May 1999, November 1999 and October 2000, the Company issued unsecured long-term notes to private institutional investors. The notes require semi-annual interest payments until maturity and have terms of five or seven years. The weighted average interest rate on the notes was 7.8% and 7.8% at March 31, 2001 and December 31, 2000, respectively. The notes may be prepaid in whole or in part together with an interest premium, as stipulated in the note agreement.

SBA DEBENTURES. At March 31, 2001 and December 31, 2000, the Company had debentures payable to the SBA with terms of ten years and at fixed interest rates ranging from 6.1% to 9.1%. The weighted average interest rate was 7.4% and 7.6% at March 31, 2001 and December 31, 2000, respectively. The debentures require semi-annual interest-only payments with all principal due upon maturity. The SBA debentures are subject to prepayment penalties if paid prior to maturity.

AUCTION RATE RESET NOTE. The Company has a $75 million Auction Rate Reset Senior Note Series A that matures on December 2, 2002 and bears interest at the three-month London Interbank Offer 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 $75 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.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

NOTE 4. DEBT, CONTINUED

Scheduled future maturities of notes payable and debentures at March 31, 2001 are as follows:

YEAR	AMOUNT MATURING (IN THOUSANDS)
2001	$ 9,350
2002	78,226
2003	140,000
2004	221,000
2005	179,000
Thereafter	87,700
Total	$715,276

REVOLVING CREDIT FACILITIES

REVOLVING LINE OF CREDIT. The Company has an unsecured revolving line of credit for $417,500,000. The facility may be expanded up to $500,000,000. At the Company's option, the 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 interest rate adjusts at the beginning of each new interest period, usually every thirty days. The interest rates were 6.7% and 7.9% at March 31, 2001 and December 31, 2000, respectively, and the facility requires an annual commitment fee equal to 0.25% of the committed amount. The line expires in March 2002. The line of credit requires monthly interest payments and all principal is due upon its expiration.

MASTER LOAN AND SECURITY AGREEMENT. The Company had a facility to borrow up to $100,000,000, using certain commercial mortgage loans as collateral. The agreement charged interest at the one-month LIBOR plus 1.0%, adjusted daily. The agreement matured on October 27, 2000 and was not renewed.

The average debt outstanding on the revolving credit facilities was $78,344,000 and $154,853,000 for the three months ended March 31, 2001 and for the year ended December 31, 2000, respectively. The maximum amount borrowed under these facilities and the weighted average interest rate for the three months ended March 31, 2001 and for the year ended December 31, 2000, were $181,500,000 and $257,000,000, and 6.7% and 7.6%, respectively.

NOTE 5. PREFERRED STOCK

Allied Investment has outstanding a total of 60,000 shares of $100 par value, 3% cumulative preferred stock and 10,000 shares of $100 par value, 4% redeemable cumulative preferred stock issued to the SBA pursuant to Section 303(c) of the Small Business Investment Act of 1958, as amended. The 3% cumulative preferred stock does not have a required redemption date. Allied Investment has the option to redeem in whole or in part the preferred stock by paying the SBA the par value of such securities and any dividends accumulated and unpaid to the date of redemption. The 4% redeemable cumulative preferred stock has a required redemption date in June 2005.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

NOTE 6. SHAREHOLDERS' EQUITY

Sales of common stock in the quarter ended March 31, 2001, and the year ended December 31, 2000 were as follows:

(IN THOUSANDS)	2001	2000
Number of common shares	444	14,812
Gross proceeds	$10,000	$263,460
Less costs including underwriting fees	(50)	(12,548)
Net proceeds	$ 9,950	$250,912

In addition, the Company issued 4,123,407 shares of common stock to acquire BLC Financial Services, Inc. in a stock-for-stock exchange on December 31, 2000 for proceeds of $86,076,000.

The Company has a dividend reinvestment plan, whereby the Company may buy shares of its common stock in the open market or issue new shares in order to satisfy dividend reinvestment requests. If the Company issues new shares, the issue price is equal to the average of the closing sale prices reported for the

Company's common stock for the five consecutive days immediately prior to the dividend payment date.

Dividend reinvestment plan activity for the three months ended March 31, 2001 and for the year ended December 31, 2000 was as follows:

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)	2001	2000
Shares issued	78	254
Average price per share	$22.74	$18.79

NOTE 7. EARNINGS PER COMMON SHARE

Earnings per common share for the three months ended March 31, 2001 and 2000 were as follows:

(IN THOUSANDS EXCEPT PER SHARE AMOUNTS)	FOR THE THREE MONTHS ENDED MARCH 31, 2001	2000
Net increase in net assets resulting from operations	$52,028	$29,581
Less preferred stock dividends	(55)	(55)
Income available to common shareholders	$54,973	$29,526
Basic shares outstanding	85,504	66,289
Dilutive options outstanding to officers	1,555	19
Diluted shares outstanding	87,059	66,308
BASIC EARNINGS PER COMMON SHARE	$ 0.61	$ 0.45
DILUTED EARNINGS PER COMMON SHARE	$ 0.60	$ 0.45

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ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

NOTE 8. CUT-OFF AWARD AND FORMULA AWARD

The Predecessor Companies' existing stock option plans were canceled and the Company established a cut-off dollar amount for all existing, but unvested options as of the date of the Merger (the "Cut-off Award"). The Cut-off Award was computed for each unvested option as of the Merger date. The Cut-off Award was equal to the difference between the market price on August 14, 1997 (the Merger announcement date) of the shares of stock underlying the option less the exercise price of the option. The Cut-off Award was payable for each unvested option upon the future vesting date of that option. The Cut-off Award was designed to cap the appreciated value in unvested options at the Merger announcement date, in order to set the foundation to balance option awards upon the Merger. The Cut-off Award approximated $2.9 million in the aggregate and has been expensed as the Cut-off Award vests. For the three months ended March 31, 2001 and for the year ended December 31, 2000, $28,000 and $535,000, respectively, of the Cut-off Award vested.

The Formula Award was established to compensate employees from the point when their unvested options would cease to appreciate in value (the Merger announcement date), up until the time at which they would be able to receive option awards in ACC post-merger. In the aggregate, the Formula Award equaled 6% of the difference between an amount equal to the combined aggregated market capitalizations of the Predecessor Companies as of the close of the market on the day before the Merger date (December 30, 1997), less an amount equal to the combined aggregate market capitalizations of Allied Lending and the Predecessor Companies as of the close of the market on the Merger announcement date. Advisers' compensation committee allocated the Formula Award to individual officers on December 30, 1997. The amount of the Formula Award as computed at December 30, 1997 was $18,994,000. This amount was contributed to the Company's deferred compensation trust and was used to purchase shares of the Company's stock (included in common stock held in deferred compensation trust). The Formula Award vested equally in three installments on December 31, 1998, 1999 and 2000. The Formula Award has been expensed in each year in which it vested. For the years ended December 31, 2000, $5,648,000 was expensed as a result of the Formula Award. At December 31, 2000, the liability related to the Formula Award was $5,648,000 and has been included in common stock held in deferred compensation trust. Vested Formula Awards have been distributed to recipients by the Company, however, sale of the Company's stock by the recipients is restricted. Unvested Formula Awards were forfeited upon a recipient's separation from service and the related Company stock was retired. During 2000, $563,000 of the Formula Award was forfeited.

NOTE 9. DIVIDENDS AND DISTRIBUTIONS

The Company's Board of Directors declared and the Company paid a $0.49 per common share dividend or $42,081,000 for the three months ended March 31, 2001.

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ITEM 2.

MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following analysis of the financial condition and results of operations of the Company should be read in conjunction with the Company's Consolidated Financial Statements and the Notes thereto included herein and in the Company's annual report on Form 10-K. This Management's Discussion and Analysis contains certain forward-looking statements. These statements include the plans and objectives of management for future operations and financial objectives, loan portfolio growth and availability of funds. These forward-looking statements are subject to the inherent uncertainties in predicting future results and conditions. Certain factors that could cause actual results and conditions to differ materially from those projected in these forward-looking statements are set forth below in the Investment Considerations section. Other factors that could cause actual results to differ materially include the uncertainties of economic, competitive and market conditions, and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond the control of the Company. Although the Company believes that the assumptions underlying the forward-looking statements included herein are reasonable, any of the assumptions could be inaccurate and, therefore, there can be no assurance that the forward-looking statements included herein will prove to be accurate. Therefore, the inclusion of such information should not be regarded as a representation by the Company or any other person that the objectives and plans of the Company will be achieved.

OVERVIEW

The Company provides private investment capital to private and undervalued public companies in a variety of different industries and in diverse geographic locations. Our lending and investment activity is focused in private finance and commercial real estate finance, primarily the purchase of commercial mortgage-backed securities.

The Company's portfolio composition at March 31, 2001, and December 31, 2000 was as follows:

	AT MARCH 31, 2001	AT DECEMBER 31, 2000
Private Finance	69%	72%
Commercial Real Estate Finance	31%	28%

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 on the interest-bearing portfolio. The Company's ability to generate interest income is dependent on economic, regulatory and competitive factors that influence interest rates and loan originations, and the Company's ability to secure financing for its investment activities.

PORTFOLIO AND INVESTMENT ACTIVITY

Total portfolio investment activity and yields as of and for the three months ended March 31, 2001 and as of and for the year ended December 31, 2000 were as follows:

($ IN MILLIONS)	AT AND FOR THE THREE MONTHS ENDED MARCH 31, 2001	AT AND FOR THE YEAR ENDED DECEMBER 31, 2000
Portfolio at Value	$1,886.8	$1,788.0
New Investments	$ 150.8	$ 901.5
Repayments	$ 26.6	$ 154.1
Sales	$ 35.2	$ 280.2
Yield	14.3%	14.1%

PRIVATE FINANCE

Private finance investment activity and yields as of and for the three months ended March 31, 2001 and as of and for the year ended December 31, 2000 were as follows:

($ IN MILLIONS)	AT AND FOR THE THREE MONTHS ENDED MARCH 31, 2001	AT AND FOR THE YEAR ENDED DECEMBER 31, 2000
Portfolio at Value	$1,303.3	$1,282.5
New Investments	$ 20.6	$ 600.9
Repayments	$ 17.1	$ 117.7
Yield	14.7%	14.6%

The private finance portfolio increased 2% from December 31, 2000 to March 31, 2001, and increased 98% during the year ended December 31, 2000. Buyout and private finance activity across the industry slowed during the first quarter of 2001 largely due to credit tightening among senior lenders. Equity-focused buyout firms generally need both senior and subordinated debt to leverage private equity investments, and during the first quarter of 2001, the senior bank market, and in particular the senior syndicated loan market, was effectively closed. As a result, the Company completed the financing for only one buyout transaction during the quarter, with the Company investing $10.0 million. The Company also funded existing financing commitments for existing portfolio companies.

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The Company's increasing capital base has enabled it to make larger private finance investments, supporting the increase in originations in 2000. Key investment characteristics for new private finance mezzanine investments were as follows:

	FOR THE YEAR ENDED DECEMBER 31, 2000
New investment characteristics:	
Number of investments	34
Average investment size (millions)	$ 14.0
Average current yield	14.7%
Average portfolio company revenue (millions)	$153.5
Average portfolio company years in business	36

The average investment 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 current yield on the private finance portfolio will fluctuate over time depending on the equity "kicker" or warrants received with each debt financing. Private finance investments are generally structured such that equity kickers may provide an additional future investment return of up to 10%.

In addition to the Company's core private finance investment activity during 2000, the Company acquired 95% of BLC Financial Services, Inc. in a "going private" buyout transaction for $95.2 million on December 31, 2000. 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. The new portfolio company has 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. As part of the recapitalization, the Company contributed certain assets, including the online rules-based underwriting technology and fixed assets, and transferred 37 employees into 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 25% subordinated debt, $25.1 million of preferred stock, and $104.5 million of common stock on December 31, 2000.

At March 31, 2001, the Company's investment in BLX totaled $211.1 million at value and consisted of $66.0 million of 25% subordinated debt, $25.1 million of preferred stock and $120.0 million of common stock. During the first quarter of 2001, BLX secured a 3-year $117.5 million revolving credit facility ("BLX Credit Facility") and completed a $65 million securitization of unguaranteed SBA 7(a) loans. As a result of the elimination of the refinancing risk that existed at the time of the merger, and BLX's progress in merger integration, the Company increased the value of its common stock investment by $15.5 million to $120.0 million at March 31, 2001. 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 March 31, 2001 was $37.7 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 March 31, 2001. In consideration for providing this guaranty, BLX will pay the Company an annual guaranty fee of $2.9 million. In addition, the Company has entered into a management

contract with BLX to provide management services, including certain technology and transition services. The Company's investment in BLX is included in the private finance portfolio.

BLX is a non-bank small business lender licensed as a participant in the SBA 7(a) Guaranteed Loan Program. BLX is headquartered in New York City, has 28 offices throughout the country and is an SBA-designated Preferred Lender in 64 markets.

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 committed amount is expected to be invested over the next three years. The Company funded $1.6 million and $7.0 million of this commitment for the three months ended March 31, 2001 and for the year ended December 31, 2000, respectively.

COMMERCIAL REAL ESTATE FINANCE

Commercial real estate finance investment activity and yields as of and for the three months ended March 31, 2001 and as of and for the year ended December 31, 2000 were as follows:

($ IN MILLIONS)	AS OF AND FOR THE THREE MONTHS ENDED MARCH 31, 2001	AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2000
Portfolio at Value........................	$583.5	$505.5
New Investments...........................	$130.2	$149.0
Repayments................................	$ 9.4	$ 24.8
Sales.....................................	$ 35.2	$151.7
Yield.....................................	13.7%	13.1%

The commercial real estate finance portfolio increased 15% from December 31, 2000 to March 31, 2001, and decreased 3% for the year ended December 31, 2000. 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 commercial mortgage-backed securities ("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 fully secured by commercial mortgage loans. The Company has opportunistically purchased CMBS since the fourth quarter of 1998. The Company plans to continue its CMBS investment activity, however, in order to maintain a balanced portfolio the Company expects that purchased CMBS will continue to represent approximately 20% to 25% of total assets during 2001. The Company's CMBS investment activity level will be dependent upon its ability to purchase CMBS at attractive yields.

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The Company purchases CMBS at an average discount of 50% from the face amount of the bonds. During the first quarter of 2001, the Company purchased $104.4 million in CMBS with a face value of $182.3 million. In addition, the Company purchased $24.6 million in non-investment grade securities related to a collateralized debt obligation secured by CMBS and investment grade REIT bonds. The weighted average yield to maturity on first quarter 2001 purchases is 15.9% after assuming a 1% loss rate on the underlying collateral mortgage pool. During 2000, the Company purchased $124.3 million in CMBS with a face amount of $244.6 million and a weighted average yield to maturity of 14.7% after assuming a 1% loss rate on the underlying collateral mortgage pool.

As part of the Company's strategy to maximize its return on equity capital, during the first quarter of 2001 the Company sold $35.2 million and during the fourth quarter of 2000 the Company sold $98.7 million of CMBS bonds rated BB+, BB and BB-. These bonds had an effective yield of 10.5% and 11.5%, and were sold for $36.1 million and $102.5 million, respectively, resulting in a realized gain on the sale. The sale of these lower-yielding bonds increased the Company's overall liquidity. The effective yield on the Company's remaining purchased CMBS portfolio at March 31, 2001 was 15.6%, after assuming a 1% loss on the entire underlying mortgage loan pool. At March 31, 2001 and December 31, 2000, the value of the purchased CMBS portfolio was $406.6 million and $311.3 million and the unamortized discount was $431.7 million and $364.9 million, respectively.

The original principal balance of the underlying pool of the approximately 2,900 loans that are collateral for the Company's CMBS had underwritten loan to value ("LTV") and underwritten debt service coverage ratios ("DSCR") as follows:

LOAN TO VALUE RANGES	$ ($ IN MILLIONS)	%
Less than 60%	$ 1,693.3	12%
60-65%	1,219.6	8%
65-70%	2,425.1	17%
70-75%	4,824.1	33%
75-80%	4,304.5	29%
Greater than 80%	190.7	1%
	$14,657.3	100%
Weighted average LTV	69.6%	

DEBT SERVICE COVERAGE RATIO RANGES	$ ($ IN MILLIONS)	%
Greater than 2.00	$ 467.6	3%
1.76-2.00	446.5	3%
1.51-1.75	1,694.7	12%
1.26-1.50	8,333.2	57%
1.00-1.25	3,715.3	25%
	$14,657.3	100%
Weighted average DSCR	1.41	

The Company has been liquidating much of its whole commercial mortgage loan portfolio so that it can redeploy the proceeds into higher yielding assets. There were no commercial mortgage loan sales for the three months ended March 31, 2001. For the year ended December 31, 2000, the Company sold $53.1 million of commercial mortgage loans. At March 31, 2001, the Company's whole commercial real estate loan portfolio had been reduced to $99.5 million from $106.4 million at December 31, 2000.

SMALL BUSINESS FINANCE

As discussed above in the Private Finance section, the Company established its Allied Capital Express operations as an independently managed private portfolio company at the end of 2000. These operations are now included in the private finance portfolio.

Allied Capital Express loan activity for the year ended December 31, 2000 was as follows:

($ IN MILLIONS)	2000
New Investments	$151.6
Repayments	$ 11.6
Sales	$128.5

Allied Capital Express loan origination activity for 2000 increased due to the opening of new regional office locations and from opportunities created by the Company's Internet site launched in the fall of 1999. Loans in the Allied Capital Express program were originated for sale; therefore, the increase in loan sales was the result of the increase in originations. In addition, beginning in 1999, the Company began to sell 90% of the unguaranteed portion of SBA 7(a) loans through a structured finance agreement with a commercial paper conduit. Allied Capital Express targeted small commercial real estate loans that were, in many cases, originated in conjunction with SBA 7(a) loans. SBA 7(a) loans were originated with variable interest rates priced at spreads ranging from 1.75% to 2.75% over the prime lending rate.

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RESULTS OF OPERATIONS

COMPARISON OF THREE MONTHS ENDED MARCH 31, 2001 AND 2000

The following table summarizes Allied Capital's operating results for the three months ended March 31, 2001 and 2000.

($ IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)	FOR THE THREE MONTHS ENDED MARCH 31, 2001	2000	CHANGE	PERCENT CHANGE
INTEREST AND RELATED PORTFOLIO INCOME				
Interest and dividends	$54,875	$38,812	$ 16,063	41%
Premiums from loan dispositions	821	3,289	(2,468)	(75)%
Investment advisory fees and other income	9,375	1,796	7,579	422%
Total interest and related portfolio income	65,071	43,897	21,174	48%

EXPENSES				
Interest	15,930	12,311	3,619	29%
Employee	6,418	4,569	1,849	40%
Administrative	2,967	2,753	214	8%
Total operating expenses	25,315	19,633	5,682	29%
Formula and cut-off awards	28	1,691	(1,663)	(98)%
Net operating income before net realized and unrealized gains	39,728	22,573	17,155	76%
NET REALIZED AND UNREALIZED GAINS				
Net realized gains	1,154	2,176	(1,022)	(47)%
Net unrealized gains	11,146	4,832	6,314	131%
Total net realized and unrealized gains	12,300	7,008	5,292	76%
Net increase in net assets resulting from operations	$52,028	$29,581	$ 22,447	76%
Diluted net operating income per share	$ 0.46	$ 0.34	$ 0.12	35%
Diluted earnings per share	$ 0.60	$ 0.45	$ 0.15	33%
Weighted average shares outstanding -- diluted	87,059	66,308	20,751	31%

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 is primarily a function of the level of interest income earned and the balance of portfolio assets. In addition, total interest and related portfolio income

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includes dividend income, premiums from loan dispositions, prepayment premiums, and investment advisory fees and other income.

($ IN MILLIONS, EXCEPT PER SHARE AMOUNTS)	FOR THE THREE MONTHS ENDED MARCH 31, 2001	2000
Total Interest and Related Portfolio Income	$65.1	$43.9
Per share	$0.75	$0.66

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 22% to $1,542.9 million at March 31, 2001 from $1,260.1 million at March 31, 2000. The weighted average yield on the interest bearing investments in the portfolio at March 31, 2001 and 2000 was as follows:

	MARCH 31, 2001	MARCH 31, 2000
Private Finance	14.7%	13.9%
Commercial Real Estate Finance	13.7%	12.5%
Small Business Finance	--%	11.3%
Total Portfolio	14.3%	13.0%

Included in net premiums from loan dispositions are premiums from loan sales and premiums received on the early repayment of loans. There were no premiums from loan sales for the three months ended March 31, 2001. For the three months ended March 31, 2000, premiums from loan sales were $2.2 million, resulting primarily from the premium paid by purchasers of loans originated through Allied Capital Express, less the origination commissions associated with the loans sold. Upon the merger of the Allied Capital Express operations into BLX, the premium from loan sales earned historically is intended to be replaced with interest income earned by the Company from its subordinated debt investment in BLX as well as fees earned from its guaranty of the BLX Credit Facility and its management contract with BLX.

Prepayment premiums were $0.8 million and $1.1 million for the three months ended March 31, 2001 and 2000, 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.

Investment advisory fees and other income include diligence and structuring fees from our investing activities of $4.8 million and management and guaranty fees from BLX of $3.7 million for the three months ended March 31, 2001. Diligence and structuring fees are separately negotiated on each portfolio investment, and therefore, may vary from quarter to quarter.

Operating expenses include interest, employee and administrative expenses. The Company's single largest expense is interest on indebtedness. The fluctuations in interest expense during the three months ended March 31, 2001 and 2000 are attributable to changes in the level of borrowings by the

Company and its subsidiaries under various notes payable and debentures and revolving credit facilities. The Company's borrowing activity and weighted average interest cost, including fees and closing costs, were as follows:

AT AND FOR THE THREE MONTHS ENDED MARCH 31,

($ IN MILLIONS)	2001	2000
Total Outstanding Debt	$883.8	$683.4
Average Outstanding Debt	$790.1	$627.3
Weighted Average Cost	7.8%	7.9%
BDC Asset Coverage*	232%	217%

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* 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 increase in salaries and employee benefits for the periods presented reflects wage increases and the experience level of employees hired. Total employees were 96 and 125 at March 31, 2001 and 2000, respectively. As part of the recapitalization of Allied Capital Express discussed above, employees of the Company were transferred to the portfolio company at the end of 2000. Expenses related to 30 employees dedicated to Allied Capital Express are reflected in employee expense and the number of employees for the three months ended March 31, 2000.

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. For the three months ended March 31, 2001 and 2000, employee and administrative costs as a percentage of total interest and related portfolio income less interest expense plus net realized and unrealized gains was 15% and 19%, respectively.

The formula and cut-off awards totaled $1.7 million, or $0.03 per share, for the three months ended March 31, 2000. The formula award vested over a three-year period which ended on December 31, 2000.

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 Purchased CMBS bonds, offset by losses on investments. Realized gains and losses were as follows:

($ IN MILLIONS)	FOR THE THREE MONTHS ENDED MARCH 31, 2001	2000
Realized Gains	$ 1.9	$ 2.7
Realized Losses	(0.7)	(0.5)
Net Realized Gains	$ 1.2	$ 2.2
Net Unrealized Gains	$11.1	$ 4.8

Realized gains for the three months ended March 31, 2001 primarily resulted from a transaction involving one portfolio company, Southwest PCS, LLC ($0.8 million). Realized gains for the three months ended March 31, 2000 resulted primarily from transactions involving two portfolio companies. The Company reversed previously recorded unrealized appreciation totaling $1.1 million and $2.1 million when these gains were realized for the three months ended March 31, 2001 and 2000, respectively.

Realized losses for the three months ended March 31, 2001 resulted from the liquidation of certain portfolio investments. Losses realized for the three months ended March 31, 2001 and 2000 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 $0.7 million and $0.4 million when the related losses were realized for the three months ended March 31, 2001 and 2000, respectively.

Net unrealized gains for the three months ended March 31, 2001 and 2000 consisted of valuation changes resulting from the Board of Directors' valuation of the Company's assets and the effect of reversals of unrealized appreciation or depreciation resulting from realized gains or losses.

The Company increased the value of its equity investment in BLX by $15.5 million at March 31, 2001. During the first quarter, BLX secured a 3-year $117.5 million revolving credit facility and completed a $65 million securitization of unguaranteed SBA 7(a) loans. As a result of the elimination of the refinancing risk that existed at the time of the merger, and BLX's progress in merger integration, the Company increased the value of its equity investment. The Company also increased the value of its investment in Wyo-Tech Acquisition Corporation by $8.8 million, due to its continued growth and positive performance. In addition to BLX and Wyo-Tech, the Company increased the value of other portfolio companies by $6.1 million in total. These companies increased in value because of continued positive performance, and valuation data that would indicate that a valuation increase was necessary.

The Company decreased the value of its common equity investment in Startec Global Communications Corporation by $3.0 million. The Company also decreased the value of its debt investment in NETtel Communications, Inc. by $5.0 million. In addition, the Company decreased the value of other portfolio companies by a total of $11.3 million.

At March 31, 2001, net unrealized appreciation in the portfolio totaled $30.5 million and was composed of unrealized appreciation of $75.5 million, resulting primarily from appreciated equity interests in portfolio companies, and unrealized depreciation of $45.0 million, resulting primarily from underperforming loan and equity interests in the portfolio. Net realized and unrealized gains can vary substantially on a quarterly basis.

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 March 31, 2001, the Company's portfolio was graded as follows:

GRADE	PORTFOLIO AT VALUE	PERCENTAGE OF TOTAL PORTFOLIO
	(IN MILLIONS)	
1	$ 430.3	22.8%
2	1,323.5	70.2%
3	35.3	1.9%
4	61.1	3.2%
5	36.6	1.9%
	$1,886.8	100.0%

Included in Grade 4 and 5 investments are assets totaling $14.4 million that are secured by commercial real estate at March 31, 2001. Grade 5 private finance investments at March 31, 2001, totaled $34.0 million, at value, or 1.8%, of the Company's total portfolio, respectively. Total Grade 4 and 5 assets as a percentage of the total portfolio at value at March 31, 2001 and December 31, 2000 and 1999 were 5.1%, 5.7% and 3.8%, 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 amount included in Grade 4 and 5 may fluctuate significantly from quarter to quarter 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 full amount of the potential loss when such exposure is identified.

At March 31, 2001, delinquencies in the underlying collateral pool for the Company's CMBS portfolio were 0.5%. The yield used to accrue interest on this portfolio assumes a 1% loss rate on the entire underlying collateral mortgage pool, and as of March 31, 2001, no losses have been realized.

For the total investment portfolio, loans greater than 120 days delinquent were $55.3 million at value at March 31, 2001, or 2.9% of the total portfolio. Included in this category are loans valued at $9.8 million that are fully secured by real estate. Loans greater than 120 days delinquent generally do not accrue interest. Loans greater than 120 days delinquent at December 31, 2000 were $56.4 million at value, or 3.2% of the total portfolio, which included $13.3 million that were fully secured by real estate. 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 120 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 our 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 current interest or dividends plus capital gains from the sale of equity securities. Therefore, the amount of loans greater than 120 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).

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) derive at least 90% of its gross income from dividends, interest, gains from the sale of securities and other specified types of income; (2) meet investment diversification requirements as defined in the Code; and (3) distribute annually to shareholders at least 90% of its investment company taxable ordinary income. 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 elect or qualify for such treatment in future years.

The weighted average common shares outstanding used to compute basic earnings per share were 85.5 million and 66.3 million for the three months ended March 31, 2001 and 2000, respectively. The increases in the weighted average shares reflect the issuance of new shares and the issuance of shares pursuant to a dividend reinvestment plan.

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 87.1 million and 66.3 million for the three months ended March 31, 2001 and 2000, respectively.

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

CASH AND CASH EQUIVALENTS

At March 31, 2001, the Company had $9.4 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 credit facilities.

DEBT

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

($ IN MILLIONS)	FACILITY AMOUNT	AMOUNT OUTSTANDING	ANNUAL INTERES COST(1)
Notes payable and debentures:			
Unsecured long-term notes payable......................	$ 544.0	$544.0	8.0%
SBA debentures..	108.8	87.4	8.3%
Auction rate reset note.................................	78.2	78.2	7.1%

OPIC loan	5.7	5.7	6.6%
Total notes payable and debentures	$ 736.7	$715.3	7.9%
Revolving credit facilities:			
Revolving line of credit	$ 417.5	$168.5	7.6%
Total debt	$1,154.2	$883.8	7.8%

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(1) The annual interest cost includes the cost of commitment fees and other facility fees.

UNSECURED LONG-TERM NOTES PAYABLE. 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.

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. The Company may borrow up to $108.8 million from the SBA under the SBIC program. At March 31, 2001, the Company has a commitment to borrow up to an additional $21.4 million from the SBA. The commitment expires on September 30, 2005.

AUCTION RATE RESET NOTE. The Company has a $75 million Auction Rate Reset Senior Note Series A that matures on December 2, 2002 and bears interest at the three-month London Inter-Bank Offer 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 $75 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. The Company has a two-year, $417.5 million unsecured revolving line of credit that expires in May 2002. This facility may be expanded up to $500 million. At the Company's option, 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 1 to 1 debt to equity capital ratio.

To support its growth during the first quarter of 2001, the Company raised $10.0 million in new equity capital primarily through the sale of shares from its shelf registration statement. The Company issues equity from time to time using a shelf registration statement 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. At March 31, 2001, total shareholders' equity had increased to $1.05 billion.

The Company's Board reviews the dividend rate quarterly, and adjusts the quarterly dividend rate throughout the year as the Company's earnings momentum builds. For the first and second quarter of 2001, the Board declared a $0.49 and $0.50 per common share dividend, respectively.

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 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 will utilize its short-term credit facilities only as a means to bridge to long-term financing. The Company evaluates its interest rate exposure on an ongoing basis. 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. To the extent deemed necessary, the Company may hedge variable and short-term interest rate exposure through interest rate swaps or other techniques. At March 31, 2001, the Company's debt to equity ratio was less than 1 to 1 and weighted average cost of funds was 7.8%. 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.

INVESTMENT CONSIDERATIONS

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.

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 the Company's 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 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. At March 31, 2001, the investment totaled $211.1 million, or 10.7% of total assets. In addition, as controlling shareholder of BLX, the Company has provided an unconditional guaranty to BLX's credit facility lenders in an amount equal to 50% of BLX's total obligations on its $117.5 million unsecured revolving credit facility. The amount guaranteed by the Company at March 31, 2001 was $37.7 million. This guaranty can only be called in the event of a default by BLX.

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 and lend to 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 collateral for the loan.

OUR PORTFOLIO OF INVESTMENTS IS ILLIQUID. We acquire most of our investments directly from private companies. The majority of the investments in our portfolio will be subject to restrictions on resale or otherwise have no established trading market. The illiquidity of most of our portfolio may adversely affect our ability to dispose of loans and securities at times when it may be advantageous for us to liquidate such investments.

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.

OUR PORTFOLIO INVESTMENTS ARE RECORDED AT FAIR VALUE AS DETERMINED 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 Board of Directors is required to value each asset quarterly, and we are required to carry our portfolio at fair value as determined by the Board of Directors. Since there is typically no public market for the loans and equity securities of the companies in which we make investments, our Board of Directors estimates the fair value of these loans and equity securities 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 loans and equity securities may differ significantly from the values that would be placed on the portfolio if there existed a ready market for the loans and equity securities. We adjust quarterly the valuation of our portfolio to reflect the Board of Directors' estimate of the current realizable value of each investment in our portfolio. Any changes in estimated value are recorded in the Company's statement of operations as "Net unrealized gains (losses)."

WE BORROW MONEY WHICH MAGNIFIES THE POTENTIAL FOR GAIN OR LOSS ON AMOUNTS INVESTED AND MAY INCREASE THE RISK OF INVESTING IN OUR COMPANY. 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. 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. 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 March 31, 2001, the Company had $883.8 million of outstanding indebtedness, bearing a weighted annual interest cost of 7.8%. In order for us to cover these annual interest payments on indebtedness, we must achieve annual returns on our portfolio of at least 3.5%.

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 March 31, 2001, our asset coverage for indebtedness was 232%.

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 portfolio 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. However, there would be no effect on the return, if any, that could be generated from our equity interests. 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 only 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.

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 net operating income excluding 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 business development company ("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.

OUR PRIVATE FINANCE INVESTMENTS MAY NOT PRODUCE CAPITAL GAINS. Private finance investments are typically structured as debt securities with a relatively high fixed rate of interest and with an equity feature such as conversion rights, warrants or options. As a result, private finance investments 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.

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 pass-through tax treatment. If the Company fails to qualify as a RIC, the Company would become subject to federal income tax as if it were an ordinary corporation, which would substantially reduce our net assets and the amount of income available for distribution to our shareholders. The Company would cease to qualify for pass-through tax treatment if it were unable to comply with these requirements, or if it ceased to qualify as a BDC under the 1940 Act. We also could be subject to a 4% excise tax and/or corporate level income tax if we fail to make required distributions.

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 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.

QUARTERLY RESULTS MAY FLUCTUATE AND MAY NOT BE INDICATIVE OF FUTURE QUARTERLY PERFORMANCE. The Company's quarterly operating results could fluctuate and therefore, you should not rely on quarterly results to be indicative of the Company's performance in future quarters. Factors that could cause quarterly operating results to fluctuate include, among others, variations in the investment origination volume, 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.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There has been no material change in the quantitative or qualitative disclosures about market risk since December 31, 2000.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The Company is party to certain lawsuits in the normal course of business. While the outcome of these legal proceedings cannot at this time be predicted with certainty, the Company does not expect that these proceedings will have a material effect upon the Company's financial condition or results of operations.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

During the three months ended March 31, 2001 ACC issued a total of 78,197 shares pursuant to a dividend reinvestment plan. This plan is not registered and relies on an exemption from registration in the Securities Act of 1933.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) List of Exhibits

EXHIBIT NUMBER	DESCRIPTION
3(i)(a)(1)	Articles of Amendment and Restatement of the Articles of Incorporation.
3(i)(b)(2)	Articles of Merger.
3(i)(c)(14)	Amendment to the Amended and Restated Articles of Incorporation.
3(ii)10	Bylaws.
4.1(4)	Specimen certificate of the Company's Common stock, par value $0.0001 per share. See exhibits 3(i), 3(ii) and 3(iii) for other instruments defining the rights of security holders.
4.2(2)	Form of debenture between certain subsidiaries of the Company and the U.S. Small Business Administration.
5	Not applicable.

9	Not applicable.
10.1(14)	Amended and Restated Credit Agreement dated May 17, 2000.
10.2(5)	Note Agreement dated as of April 30, 1998.
10.3(3)	Loan Agreement between Allied I and Overseas Private Investment Corporation, dated April 10, 1995. Letter dated December 11, 1997 evidencing assignment of Loan Agreement from Allied I to the Company.
10.4(8)	Note Agreement dated as of May 1, 1999.
10.4a(10)	Note Agreement dated as of November 15, 1999.
10.4b(13)	Note Agreement dated as of October 15, 2000.

EXHIBIT NUMBER	DESCRIPTION
10.4c(14)	Auction Rate Reset Note Agreement, dated as of August 31, 2000 between the Company and Intrepid Funding Master Trust, a Delaware business trust administered by Banc of America Securities LLC; Forward Issuance Agreement, dated as of August 31, 2000, between the Company and Banc of America Securities LLC; Remarketing and Contingency Purchase Agreement, dated as of August 31, 2000 between the Company and Banc of America Securities LLC.
10.5(14)	Amendment and Consent Agreement to the Amended and Restated Credit Agreement dated December 11, 2000.
10.6(4)	Sale and Servicing Agreement dated as of January 1, 1998 among Allied Capital CMT, Inc., Allied Capital Commercial Mortgage Trust 1998-1 and the Company and LaSalle National Bank Inc. and ABN AMRO Bank N.V.
10.7(4)	Indenture dated as of January 1, 1998 between Allied Capital Commercial Mortgage Trust 1998-1 and LaSalle National Bank.
10.8(4)	Amended and Restated Trust Agreement dated January 1, 1998 between Allied Capital CMT, Inc., LaSalle National Bank Inc. and Wilmington Trust Company.
10.9(4)	Guaranty dated as of January 1, 1998 by the Company.
10.10a(14)	Employment agreement dated June 15, 2000 between the Company and William L. Walton.
10.10b(14)	Employment agreement dated June 15, 2000 between the Company and Joan M. Sweeney.
10.10c(14)	Employment agreement dated June 15, 2000 between the Company and John M. Scheurer.
10.11(7)	Amended and Restated Deferred Compensation Plan dated December 30, 1998.
10.11a(14)	Amendment to Deferred Compensation Plan dated October 18, 2000.
10.12(6)	Amended Stock Option Plan.
10.12a(9)	Allied Capital 401(k) Plan dated September 1, 1999.
10.12b(14)	Amendment to 401(k) Plan dated December 31, 2000.
10.13a(4)	Form of Custody Agreement with Riggs Bank N.A. with respect to safekeeping.
10.13b(4)	Form of Custody Agreement with La Salle National Bank.
10.14a(11)	Agreement and Plan of Merger dated October 31, 2000 by and among the Company, Allied Capital B Sub Corporation, and BLC Financial Services, Inc.
10.14b(12)	Voting and Support Agreement with key shareholders of BLC Financial Services, Inc.

10.14c(12)	Lockup Agreement with key shareholders of BLC Financial Services, Inc.
10.14d(12)	Agreement and Plan of Merger dated as of October 31, 2000 by and among the Company, Allied Capital F Sub Corporation and Futuronics Corporation.
10.14e(12)	Voting and Support Agreement with key shareholders of Futuronics Corporation dated October 31, 2000.
10.14f(12)	Lockup Agreement with key shareholders of Futuronics Corporation dated October 31, 2000.
10.15(14)	Control Investor Guaranty Agreement, dated as of March 28, 2001, between the Company and Fleet National Bank, in its capacity as Administrative Agent for the Lenders and Business Loan Express, Inc.
10.18(1)	Dividend Reinvestment Plan.

EXHIBIT NUMBER	DESCRIPTION
11	Statement regarding computation of per share earnings is incorporated by reference to Note 8 to the Company's Notes to the Consolidated Financial Statements contained in the Company's 2000 Annual Report on Form 10-K for the year ended December 31, 2000.
21	Subsidiaries of the Company and jurisdiction of incorporation/organization:

Allied Investment Corporation	Maryland
Allied Capital REIT, Inc.	Maryland
Allied Capital Holdings LLC	Delaware
Allied Capital Beteiligungsberatung GmbH	Germany

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(1) Incorporated by reference to the exhibit of the same name filed with the Company's Annual Report on Form 10-K for the year ended December 31, 1997.

(2) Incorporated by reference to the exhibit of the same name filed with Allied I's Annual Report on Form 10-K for the year ended December 31, 1996.

(3) Incorporated by reference to Exhibit f.7 of Allied I's Pre-Effective Amendment No. 2 filed with the registration statement on Form N-2 on January 24, 1996 (File No. 33-64629). Assignment to Company is incorporated by reference to Exhibit 10.3 of the Company's Annual Report on Form 10-K for the year ended December 31, 1997.

(4) Incorporated by reference to the exhibit of the same name to the Company's registration statement on Form N-2 filed on the Company's behalf with the Commission on May 5, 1998 (File No. 333-51899).

(5) Incorporated by reference to the exhibit of the same name filed with the Company's Quarterly Report on Form 10-Q for the period ended September 30, 1998.

(6) Incorporated by reference to Exhibit A of the Company's definitive proxy materials for the Company's 2000 Annual Meeting of Stockholders filed with the Commission on March 29, 2000.

(7) Incorporated by reference to the exhibit of the same name filed with the Company's Annual Report on Form 10-K for the year ended December 31, 1998.

(8) Incorporated by reference to the exhibit of the same name filed with the Company's Quarterly Report on Form 10-Q for the period ended June 30, 1999.

(9) Incorporated by reference to Exhibit 4.4 of the Allied Capital 401(k) Plan registration statement on Form S-8, filed on behalf of such Plan on October 8, 1999 (File No. 333-88681).

(10) Incorporated by reference to the exhibit of the same name filed with the Company's Annual Report on Form 10-K for the year ended December 31, 1999.

(11) Incorporated by reference to Appendix A to the Company's registration statement on Form N-14 filed on the Company's behalf with the Commission on November 6, 2000.

(12) Incorporated by reference to the exhibit of the same name to the Company's registration statement on Form N-14 filed on the Company's behalf with the Commission on November 6, 2000.

(13) Incorporated by reference to the exhibit of the same name to the Company's Quarterly Report on Form 10-Q for the period ended September 30, 2000.

(14) Incorporated by reference to the exhibit of the same name to the Company's registration statement on Form N-2 (File No. 333-43534) as amended.

(b) Reports on Form 8-K.

The Company filed no reports on Form 8-K during the quarter ended March 31, 2001.

SIGNATURES

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

ALLIED CAPITAL CORPORATION
(Registrant)

Dated: May 15, 2001

/s/ PENNI F. ROLL

Executive Vice President and Chief Finan
Officer