ALLIED CAPITAL CORP
Form 497
February 25, 2002

PROSPECTUS SUPPLEMENT
(To Prospectus dated December 19, 2001)

Filed Pursuant to Rule 497 Registration
Statement No. 333-67336

784,555 Shares
COMMON STOCK

All of the 784,555 shares of the common stock, par value $.0001 per share, of Allied Capital Corporation are being issued and sold by us to an institutional investor at negotiated purchase prices for total offering proceeds to the Company of $20 million.

These negotiated purchase prices, per share, are equal to the Volume Weighted Average Price on the New York Stock Exchange, as reported by Bloomberg L.P. using the AQR function for the shares (the Average Trading Price), less a discount of 3% (the Purchase Price), for each of the fourteen trading days during the period from February 4, 2002 to February 22, 2002 (the Investment Period).

The total number of shares offered hereby equals the aggregate number of shares resulting from:

(i) the allocation of the purchaser s proposed aggregate investment of $20 million on a pro rata basis over the Investment Period; and

(ii) the purchase, on each day during the Investment Period on which the Average Trading Price exceeds $22.00 (the Threshold Price) or on which the Average Trading Price is below the Threshold Price and the purchaser chooses to purchase shares at the Threshold Price, of the maximum number of whole shares at the Purchase Price.

This results in the purchase of a total of 784,555 shares at an average purchase price per share of $25.49.

Our common stock is traded on the New York Stock Exchange under the symbol ALD. On February 22, 2002, the last reported sales price for the common stock was $27.00.

We are an internally managed closed-end management investment company that has elected to be regulated as a business development company under the Investment Company Act of 1940, as amended. Our investment objective is to achieve current income and capital gains.

Please read this prospectus supplement, and the accompanying prospectus, before investing, and keep it for future reference. It contains important information about the Company. To learn more about the Company, you may want to look at the Statement of Additional Information dated December 19, 2001 (known as the SAI). For a free copy of the SAI, contact us at Allied Capital Corporation, 1919 Pennsylvania Avenue, N.W., Washington, DC 20006, 1-888-253-0512. We have filed the SAI with the U.S. Securities and Exchange Commission and have incorporated it by reference into the prospectus. The SAI s table of contents appears on page B-1 of the prospectus. The Commission maintains an Internet website (http://www.sec.gov) that contains the SAI, material incorporated by reference and other information about the Company.

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

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

February 22, 2002

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

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Information contained or incorporated by reference in this prospectus supplement, and the prospectus, may contain forward-looking statements which can be identified by the use of forward-looking terminology such as may, will, expect, intend, anticipate, estimate, or continue or the negative thereof or other variations thereon or comparable terminology. The matters described in Risk Factors in the prospectus and certain other factors noted throughout this prospectus supplement and the prospectus, and in any exhibits to the registration statement of which this prospectus supplement and the prospectus are a part, constitute cautionary statements identifying important factors with respect to any such forward-looking statements, including certain risks and uncertainties, that could cause actual results to differ materially from those in such forward-looking statements. In this prospectus supplement and the prospectus, unless otherwise indicated, the Company , we , us or our refer to Allied Capital Corporation and its subsidiaries.

FEES AND EXPENSES

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

Shareholder Transaction Expenses	
Privately negotiated transaction (as a percentage of offering price)(1)	3.0%
Dividend reinvestment plan fees(2)	None
Annual Expenses (as a percentage of consolidated net assets attributable to common shares)(3)	
Operating expenses(4)	3.4%
Interest payments on borrowed funds(5)	5.1%
Total annual expenses(6)	8.5%

(1) The discount with respect to the shares sold by the Company in this offering is the only sales load paid in connection with this offering.
(2) The expenses of the Company s DRIP plan are included in Operating expenses. The Company has no cash purchase plan. The participants in the DRIP plan will bear a pro rata share of brokerage commissions incurred with respect to open market purchases, if any. See Dividend Reinvestment Plan in the prospectus.
(3) Consolidated net assets attributable to common shares equals net assets (*i.e.,* total assets less total liabilities and preferred stock) at September 30, 2001.
(4) Operating expenses represent the estimated operating expenses of the Company for the year ending December 31, 2001 excluding interest on indebtedness. This percentage for the year ended December 31, 2000 was 3.4%.
(5) The Interest payments on borrowed funds represent estimated interest payments for the year ending December 31, 2001. The Company had outstanding borrowings of $924.5 million at September 30, 2001. This percentage for the year ended December 31, 2000 was 5.6%. See Risk Factors in the prospectus.
(6) Total annual expenses as a percentage of consolidated net assets attributable to common stock are higher than the total annual expenses percentage would be for a company that is not leveraged. The Company borrows money to leverage its net assets and to increase its total assets. The Securities and Exchange Commission requires that Total annual expenses percentage be calculated as a percentage of *net* assets, rather than the total assets, including assets that have been funded with borrowed money. If the Total annual expenses percentage were calculated instead as a percentage of consolidated total assets, Total annual expenses for the Company would be 4.9% of consolidated total assets.

Example

The following example, required by the Commission, demonstrates the projected dollar amount of total cumulative expenses that would be incurred over various periods with respect to a hypothetical investment in the Company. In calculating the following expense amounts, we assumed we would have no additional leverage and that our operating expenses would remain at the levels set forth in the table above.

	1 Year	3 Years	5 Years	10 Years
You would pay the following expenses on a $1,000 investment, assuming a 5% annual return	$113	$280	$447	$868

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

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

RECENT DEVELOPMENTS

Operating Results

For the year ended December 31, 2001, the Company reported net income of $200.7 million, or $2.16 per share, an 11% increase on a per share basis as compared to earnings of $143.1 million, or $1.94 per share, for 2000. For the three months ended December 31, 2001, the Company reported net income of $42.9 million, or $0.43 per share, as compared to net income of $42.3 million, or $0.52 per share, for the three months ended December 31, 2000. Net income varies substantially from quarter to quarter due to the varied timing of events that result in net realized and unrealized gains or losses. As a result, quarterly comparisons of net income may not be meaningful.

Net operating income before net realized and unrealized gains or losses was $179.1 million, or $1.92 per share for 2001, a 25% increase on a per share basis as compared to net operating income of $112.7 million, or $1.53 per share, for 2000. For the fourth quarter of 2001, net operating income before net realized and unrealized gains or losses totaled $53.0 million, or $0.53 per share, a 26% increase on a per share basis as compared to fourth quarter 2000 net operating income of $34.7 million, or $0.42 per share.

Net realized and unrealized gains totaled $21.3 million, or $0.23 per share, for 2001 as compared to $30.4 million, or $0.41 per share, for 2000. For the year ended December 31, 2001, the Company recognized realized gains of $10.1 million and realized losses of $9.4 million.

During 2001, the Company invested a total of $680.3 million. After total repayments of $74.5 million, asset sales of $130.0 million and valuation changes during the year, total assets increased to $2.46 billion at December 31, 2001, a 33% increase over total assets of $1.85 billion at December 31, 2000. Shareholders equity increased 31% to $1.35 billion at December 31, 2001 from $1.03 billion at December 31, 2000. Net asset value per share at December 31, 2001 was $13.57, a 12% increase over the net asset value per share of $12.11 at December 31, 2000.

For the year ended December 31, 2001, the Company s total return to shareholders was 35%, including reinvestment of dividends and share price appreciation during the year. The annual return on average assets was 9% and the annual return on average equity was 17% for the year ended December 31, 2001.

For 2001, private finance investments totaled $287.7 million and commercial real estate investments totaled $392.6 million. For the fourth quarter of 2001, total new loans and investments were $170.7 million. At December 31, 2001, the overall weighted average yield on the Company s portfolio was 14.3%, as compared to 14.1% at December 31, 2000.

Private Finance

The private finance portfolio totaled $1.60 billion at December 31, 2001. The debt portion of this portfolio, which totaled $1.11 billion at December 31, 2001, had a weighted average yield of 14.8%, as compared to 14.6% at December 31, 2000. During the fourth quarter of 2001, the Company invested a total of $60.9 million in its core private finance business. Significant new private finance investments during the fourth quarter of 2001 included:

$15.0 million in subordinated debt to support the acquisition of HSCA by MedAssets HSCA, a healthcare outsourcing company;

$13.0 million in subordinated debt and equity capital in a recapitalization of Elmhurst Consulting LLC, an implementation-focused supply chain consulting firm;

$11.0 million of subordinated debt with warrants to recapitalize Advantage Mayer, Inc., one of the country s leading regional food brokers; and

$5.1 million in preferred stock to fund the growth of Foresite Towers LLC, a developer of communications towers.

CMBS Investing

During the year ended December 31, 2001, the Company s commercial real estate finance group invested $390.4 million in non-investment grade commercial mortgage-backed securities (CMBS) in nine separate transactions. For the year ended December 31, 2001, the Company sold a total of $124.5 million of CMBS. During the fourth quarter of 2001, the Company invested $109.6 million in CMBS in three separate transactions.

At December 31, 2001, the Company s portfolio of CMBS, all of which was acquired directly from the original issuers, totaled $582.6 million, or 24% of total assets, and had a weighted average yield to maturity of 14.8%. Because the Company has acquired its CMBS investments at an approximate discount of 50% from the face amount of the bonds, the unamortized discount on the CMBS portfolio at December 31, 2001 totaled $611.9 million.

From time to time, the Company will purchase lower yielding BB bonds in anticipation of future opportunities to sell such bonds at a premium. In February 2002, the Company completed the sale of $122.6 million of BB+, BB and BB- bonds that were purchased during 2001, 2000 and 1999.

Liquidity and Capital Resources

During 2001, the Company raised $286.9 million of new equity in eight separate placements. In addition, the Company obtained additional unsecured long-term debt of $150 million. The Company also expanded its committed unsecured revolving credit facility to $497.5 million, of which $352.8 million was available at December 31, 2001.

At December 31, 2001, the Company had a weighted average cost of debt of 7.0%. At December 31, 2001, the Company had regulatory asset coverage of 245% and the ratio of debt to equity was 0.75 to 1. The Company is required to maintain regulatory asset coverage of at least 200%.

Portfolio Quality and Valuation

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

At December 31, 2001, the portfolio of Grade 1 investments totaled $603.3 million, or 26% of the total portfolio at value; Grade 2 investments totaled $1.55 billion, or 67% of the total portfolio; Grade 3 investments totaled $79.5 million, or 3% of the total portfolio; Grade 4 investments totaled $44.5 million, or 2% of the total portfolio; and Grade 5 investments totaled $48.5 million, or 2% of the total portfolio. Included in Grade 4 and 5 investments are assets totaling $6.6 million that are secured by commercial real estate.

For the total investment portfolio, loans greater than 90 days past due were $39.1 million at value at December 31, 2001, or 2% of the total portfolio. Included in this category are loans valued at

$14.1 million that are secured by commercial real estate. At December 31, 2001, greater than 30-day delinquencies in the underlying collateral pool related to the CMBS portfolio were 0.45%.

Quarterly Dividend

The Company increased its regular quarterly dividend to $0.53 per share for the first quarter of 2002. The dividend is payable on March 28, 2002 to shareholders of record on March 15, 2002.

For 2001, the Company paid total dividends of $2.01 per share, a 10.4% increase over total dividends of $1.82 per share in 2000. The Company s dividend is paid from taxable income. The Board determines the dividend, based on annual estimates of taxable income, which differs from book income due to both timing and absolute differences in income and expense recognition. Changes in unrealized appreciation and depreciation have no impact on the Company s taxable income.

SUMMARY FINANCIAL INFORMATION

(In thousands, except per share amounts)	At December 31, 2001	At December 31, 2000
ASSETS		
Portfolio at Value:		
Private finance	$1,595,072	$1,282,467
Commercial real estate finance	734,518	505,534
Total Portfolio at Value	2,329,590	1,788,001
Cash and cash equivalents	889	2,449
Other assets	130,234	63,367
Total Assets	$2,460,713	$1,853,817
LIABILITIES and SHAREHOLDERS EQUITY		
Liabilities:		
Debt	$1,020,806	$786,648
Other liabilities	80,784	30,477
	1,101,590	817,125
Preferred stock	7,000	7,000
Common shareholders equity	1,352,123	1,029,692

Total Liabilities and Shareholders Equity	$2,460,713	$1,853,817
Net asset value per common share	$13.57	$12.11
Common shares outstanding at end of year	99,607	85,057

(In thousands, except per share amounts)	**3 Months Ended December 31**		**12 Months Ended December 31**	
	2001	**2000**	**2001**	**2000**
	(unaudited)			
Interest and Related Portfolio Income:				
Interest and dividend income	$66,742	$52,539	$240,464	$182,307
Premiums from loan dispositions	434	5,386	2,504	16,138
Fees and other income	15,490	3,810	46,142	13,144
Total Interest and Related Portfolio Income	82,666	61,735	289,110	211,589
Expenses:				
Interest	17,130	15,767	65,104	57,412
Employee	7,387	6,519	29,656	26,025
Administrative	5,133	4,724	15,299	15,435

Total Operating Expenses	29,650	27,010	110,059	98,872
Net Operating Income Before Net Realized and Unrealized Gains (Losses)	53,016	34,725	179,051	112,717
Net Realized and Unrealized Gains (Losses):				
Net realized gains (losses)	(7,678)	(7,572)	661	15,523
Net unrealized gains (losses)	(2,860)	15,128	20,603	14,861
Total Net Realized and Unrealized Gains (Losses)	(10,538)	7,556	21,264	30,384
Net Income Before Income Taxes	42,478	42,281	200,315	143,101
Income tax benefit	412		412	
Net Increase in Net Assets Resulting From Operations	$42,890	$42,281	$200,727	$143,101

Diluted net operating income per share	$0.53	$0.42	$1.92	$1.53
Diluted earnings per share	$0.43	$0.52	$2.16	$1.94
Weighted average shares outstanding diluted	100,052	81,612	93,003	73,472

Certain reclassifications have been made to the 2000 balances to conform to the 2001 financial statement presentation.

USE OF PROCEEDS

The net proceeds from the sale of the shares, after deducting estimated expenses of this offering, are approximately $19.95 million. We intend to use the net proceeds from selling shares to finance our Company s growth and for general corporate purposes, which may include investment in private growth companies, purchase of commercial mortgage-backed securities and acquisitions. We may also repay a portion of our revolving line of credit.

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

PLAN OF DISTRIBUTION

All of the 784,555 shares of common stock, par value $0.0001 per share, that we are offering by this prospectus supplement and the accompanying prospectus are being issued and sold to an institutional investor at negotiated purchase prices for total offering proceeds to the Company of $20 million.

These negotiated purchase prices, per share, are equal to the Volume Weighted Average Price on the New York Stock Exchange, as reported by Bloomberg L.P. using the AQR function for the shares (the Average Trading Price), less a discount of 3.0% (the Purchase Price), for each of the fourteen trading days during the period from February 4, 2002 to February 22, 2002 (the Investment Period). The total number of shares offered hereby equals the aggregate number of shares resulting from:

(i) the allocation of the purchaser s proposed aggregate investment of $20 million on a pro rata basis over the Investment Period, and

(ii) the purchase, on each day during the Investment Period on which the Average Trading Price exceeds $22.00 (the Threshold Price) or on which the Average Trading Price is below the Threshold Price and the purchaser chooses to purchase shares at the Threshold Price, of the maximum number of whole shares at the Purchase Price. This results in the purchase of a total of 784,555 shares at an average purchase price per share of $25.49.

The net offering proceeds to us, after deduction of estimated offering expenses of approximately $50,000, will be approximately $19.95 million.

PROSPECTUS

$300,000,000

Common Stock
Preferred Stock
Debt Securities

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

To learn more about the Company, you may want to look at the Statement of Additional Information dated December 19, 2001 (known as the SAI). For a free copy of the SAI, contact us at:

Allied Capital Corporation
1919 Pennsylvania Avenue, N.W.
Washington, DC 20006
1-888-253-0512

The Company has filed the SAI with the U.S. Securities and Exchange Commission and has incorporated it by reference into this prospectus. The SAI s table of contents appears on page 82 of this prospectus.

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

Our common stock is traded on the New York Stock Exchange under the symbol ALD. As of December 19, 2001, the last reported sales price on the New York Stock Exchange for the common stock was $25.24.

We may offer, from time to time, up to $300,000,000 of our common stock, par value $0.0001 per share, preferred stock, or debt securities in one or more offerings. All shares of common stock, preferred stock, and debt securities that are offered under this prospectus are collectively referred to herein as the Securities.

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

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

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

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

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

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

December 19, 2001

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

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PROSPECTUS SUMMARY

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

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

THE COMPANY *(Page 14)*

We are a business development company and provide private investment capital to private and undervalued public companies in a variety of different industries throughout the United States. We have been investing in growing businesses for over 40 years and have financed thousands of companies nationwide. Our investment activity is focused in two areas:

- private finance, and
- commercial real estate finance, primarily the purchase of commercial mortgage-backed securities (CMBS).

Our investment portfolio includes:

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

We identify loans and investments through our numerous relationships with:

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

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

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

We are an internally managed diversified closed-end management investment company that has elected to be regulated as a business development company (BDC) under the Investment Company Act of 1940, as amended (1940 Act). Our investment objective is to achieve current income and capital gains. We seek to achieve our investment objective by investing in growing businesses in a variety of industries throughout the United States. As a BDC, we are required to meet regulatory tests, the most significant relating to its investments and borrowings. A BDC is required to invest at least 70% of its assets in private or thinly traded public, U.S.-based companies. A BDC must maintain a coverage ratio of assets to senior securities of at least 200%. See Business Certain Government Regulations.

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

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THE OFFERING *(Page 80)*

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

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

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

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

USE OF PROCEEDS *(Page 14)*

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

DISTRIBUTIONS *(Page 15)*

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

DIVIDEND REINVESTMENT PLAN *(Page 74)*

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

PRINCIPAL RISK FACTORS *(Page 8)*

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

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

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

Also, we are subject to certain risks associated with investing in non-investment grade CMBS, valuing our portfolio, changing interest rates, accessing additional capital, fluctuating quarterly results, and operating in a regulated environment. In addition, the loss of pass-through tax treatment could have a material adverse effect on our total return, if any.

CERTAIN ANTI-TAKEOVER

PROVISIONS *(Page 77)*

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

FEES AND EXPENSES

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

Shareholder Transaction Expenses	
Sales load (as a percentage of offering price)(1)	%
Dividend reinvestment plan fees(2)	None
Annual Expenses (as a percentage of consolidated net assets attributable to common stock)(3)	
Operating expenses(4)	3.4%
Interest payments on borrowed funds(5)	5.1%
Total annual expenses(6)	8.5%

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

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

(3) Consolidated net assets attributable to common stock equals net assets (*i.e.*, total assets less total liabilities and preferred stock) at September 30, 2001.

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

(5) The Interest payments on borrowed funds represents the estimated interest payments of the Company for the year ending December 31, 2001. The Company had outstanding borrowings of $924.5 million at September 30, 2001. This percentage for the year ended December 31, 2000 was 5.6%. See Risk Factors.

(6) Total annual expenses as a percentage of consolidated net assets attributable to common stock are higher than the total annual expenses percentage would be for a company that is not leveraged. The Company borrows money to leverage its net assets and increase its total assets. The Securities and Exchange Commission requires that Total annual expenses percentage be calculated as a percentage of *net* assets, rather than the total assets, including assets that have been funded with borrowed monies. If the Total annual expenses percentage were calculated instead as a percentage of consolidated total assets, Total annual expenses for the Company would be 4.9% of consolidated total assets.

Example

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

	1 Year	3 Years	5 Years	10 Years
You would pay the following expenses on a $1,000 investment, assuming a 5.0% annual return	$85	$254	$425	$852

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

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

SELECTED CONSOLIDATED FINANCIAL DATA

You should read the consolidated financial information below with the Consolidated Financial Statements and Notes thereto included in this prospectus. Financial information for the years ended December 31, 2000, 1999, 1998, 1997 and 1996 has been derived from audited financial statements. On December 31, 1997, the Company consummated a merger of five predecessor companies. The selected financial data and all other information in this prospectus, unless otherwise indicated, reflects the operations of the Company with all periods restated as if the predecessor companies had merged as of the beginning of the earliest period presented. Quarterly financial information is derived from unaudited financial data, but in the opinion of management, reflects all adjustments (consisting only of normal recurring adjustments) which are necessary to present fairly the results for such interim periods. Interim results at and for the nine months ended September 30, 2001 are not necessarily indicative of the results that may be expected for the year ending December 31, 2001. **See Management s Discussion and Analysis of Financial Condition and Results of Operations on page 16 for more information.**

(In thousands, except per share data)	**Nine Months Ended September 30,**		**Year Ended December 31,**				
	2001	**2000**	**2000**	**1999**	**1998**	**1997(7)**	**1996(7)**
	(Unaudited)						
Operating Data:							
Interest and related portfolio income:							
Interest and dividends	$173,722	$129,768	$182,307	$121,112	$80,281	$86,882	$77,541
Premiums from loan dispositions	2,070	10,752	16,138	14,284	5,949	7,277	4,241
Post-merger gain on securitization of commercial mortgage loans					14,812		
Fees and other income	30,652	9,334	13,144	5,744	5,696	3,246	3,155
Total interest and related portfolio income	206,444	149,854	211,589	141,140	106,738	97,405	84,937

Expenses:

Interest	47,974	41,645	57,412	34,860	20,694	26,952	20,298
Employee(1)	22,269	19,506	26,025	22,889	18,878	10,258	8,774
Administrative	10,166	10,711	15,435	12,350	11,921	8,970	8,289
Merger			5,159				
Total operating expenses	80,409	71,862	98,872	70,099	51,493	51,339	37,361
Net operating income before net realized and unrealized gains	126,035	77,992	112,717	71,041	55,245	46,066	47,576

Net realized and unrealized gains:

Net realized gains	8,339	23,095	15,523	25,391	22,541	10,704	19,155
Net unrealized gains (losses)	23,463	(267)	14,861	2,138	1,079	7,209	(7,412)
Total net realized and unrealized gains	31,802	22,828	30,384	27,529	23,620	17,913	11,743
Income before minority interests and income taxes	157,837	100,820	143,101	98,570	78,865	63,979	59,319
Minority interests			1,231	2,427			
Income tax expense		787	1,444	1,945			

Net increase in net assets resulting from operations	$157,837	$100,820	$143,101	$98,570	$78,078	$61,304	$54,947
Per Share:							
Diluted net operating income per common share(2)	$1.39	$1.10	$1.53	$1.18	$1.06	$1.04	$1.01
Diluted earnings per common share	$1.74	$1.42	$1.94	$1.64	$1.50	$1.24	$1.17
Dividends per common share(3)	$1.50	$1.36	$1.82	$1.60	$1.43	$1.71	$1.23
Weighted average common shares outstanding diluted(4)	90,864	70,777	73,472	60,044	51,974	49,251	46,733

(in thousands, except per share data)	At September 30, 2001	At December 31, 2000	1999	1998	1997(7)	1996(7)
	(Unaudited)					
Balance Sheet Data:						
Portfolio at value	$2,174,373	$1,788,001	$1,228,497	$807,119	$703,331	$612,411
Portfolio at cost	2,128,726	1,765,895	1,222,901	803,479	697,030	618,319
Total assets	2,266,833	1,853,817	1,290,038	856,079	807,775	713,360
Total debt outstanding(5)	924,484	786,648	592,850	334,350	347,663	274,997
Preferred stock issued to SBA(5)	7,000	7,000	7,000	7,000	7,000	7,000
Shareholders equity	1,300,237	1,029,692	667,513	491,358	420,060	402,134
Shareholders equity per common share (NAV)	$13.42	$12.11	$10.20	$8.79	$8.07	$8.34
Common shares outstanding at period end(4)	96,921	85,057	65,414	55,919	52,047	48,238

	Nine Months Ended September 30, 2001	2000	Year Ended December 31, 2000	1999	1998	1997(7)	1996(7)
	(Unaudited)						
Other Data:							
Portfolio investments funded	$509,578	$640,196	$901,545	$751,871	$524,530	$364,942	$283,295
Loan repayments	52,016	117,940	154,112	145,706	138,081	233,005	179,292
Loan sales(6)	129,980	151,834	280,244	198,368	81,013	53,912	27,715
Realized gains	9,942	24,664	28,604	31,536	25,757	15,804	30,417
Realized losses	(1,603)	(1,569)	(13,081)	(6,145)	(3,216)	(5,100)	(11,262)

(1) Employee expenses include formula and cut-off awards of $91,000 and $4,797,000 for the nine months ended September 30, 2001 and 2000, respectively, and $6,183,000, $6,753,000 and $7,049,000 for the years ended December 31, 2000, 1999 and 1998, respectively. See Management s Discussion and Analysis of Financial Condition and Results of Operations Results of Operations Comparison of Nine Months Ended September 30, 2001 and 2000 and Fiscal Years Ended December 31, 2000, 1999 and 1998.

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

(3)

Distributions are based on taxable income, which differs from income for financial reporting purposes. In 1997, Allied Capital Corporation (old) distributed $0.34 per common share representing the 844,914 shares of Allied Capital Lending Corporation distributed in conjunction with the merger. The distribution resulted in a partial return of capital. Also in conjunction with the merger, the Company distributed $0.17 per common share representing the undistributed earnings of the predecessor companies at December 31, 1997.

(4) Excludes 259,983 common shares held in the deferred compensation trust at or for the nine months ended September 30, 2000, and 234,977, 516,779 and 810,456 common shares held in the deferred compensation trust at or for the years ended December 31, 2000, 1999, and 1998, respectively. There were no shares held in the deferred compensation trust at or during the nine months ended September 30, 2001.

(5) See Senior Securities on page 37 for more information regarding the Company s level of indebtedness.

(6) Excludes loans sold through securitization in January 1998. See Management s Discussion and Analysis of Financial Condition and Results of Operations Results of Operations Comparison of the Years Ended December 31, 2000, 1999 and 1998.

(7) Our current business and investment portfolio resulted from the merger of five affiliated companies on December 31, 1997. The companies that merged were Allied Capital Corporation (old), Allied Capital Corporation II, Allied Capital Advisers, Inc. (Advisers), Allied Capital Commercial Corporation and Allied Capital Lending Corporation. The five companies are referred to as the predecessor companies. The selected consolidated financial data reflects the operations of the company as if the predecessor companies were merged for these periods.

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

[Additional columns below]

[Continued from above table, first column(s) repeated]

(in thousands, except per share data)	1999			
	Qtr 4	Qtr 3	Qtr 2	Qtr 1
	(unaudited)			
Quarterly Data:				
Total interest and related portfolio income	$42,278	$37,998	$33,186	$27,678
Net operating income before net realized and unrealized gains	21,319	19,273	16,619	13,830
Net increase in net assets resulting from operations	30,925	26,944	22,121	18,580
Diluted net operating income per share	$0.34	$0.31	$0.28	$0.24
Diluted earnings per common share	0.49	0.44	0.38	0.33
Dividends declared per common share	0.40	0.40	0.40	0.40
Net asset value per common share(1)	10.20	9.66	9.17	9.00

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

WHERE YOU CAN FIND ADDITIONAL INFORMATION

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

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

RISK FACTORS

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

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

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

On September 11, 2001, a terrorist attack occurred at the World Trade Center in New York City and the Pentagon in Washington, D.C. This incident has had pervasive negative impacts on several U.S. industries and on the U.S. economy in general. While we were not directly impacted by the event, we believe that we could be impacted indirectly. The indirect impacts may include our need to provide a deferral of interest payments to certain portfolio companies that may be affected by the resulting economic slow down and a decrease in the pace of our investment activity.

Our business of making private equity investments and positioning them for liquidity events also may be impacted by current and future market conditions. The absence of a robust bank lending environment may slow the amount of private equity investment activity generally. As a result, the pace of our investment activity may slow. In addition, significant changes in the capital markets could have an effect on the valuations of private companies and on the potential for liquidity events involving such companies. This could affect the amount and timing of gains realized on our investments. We cannot assure you that the events of September 11, 2001 and the reaction to them may not have other material and adverse implications for us and for the market in general.

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 September 30, 2001, the investment totaled $225.5 million, or 10% of total assets. In addition, as controlling shareholder of BLX, we have provided an unconditional guaranty to BLX s credit facility lenders in an amount equal to 50% of BLX s total obligations on its $117.5 million unsecured revolving credit facility. The amount we have guaranteed at September 30, 2001 was $50.3 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.

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.

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 or the CMBS that we purchase, our Board of Directors estimates the fair value of these investments pursuant to a written valuation policy and a consistently applied valuation process. Unlike banks, we are not permitted to provide a general reserve for anticipated loan losses; we are instead required by the 1940 Act to specifically value each individual investment and record an unrealized loss for an asset that we believe has become impaired. Without a readily ascertainable market value, the estimated value of our portfolio of investments may differ significantly from the values that would be placed on the portfolio if there existed a ready market for the investments. We adjust quarterly the valuation of our portfolio to reflect the Board of Directors estimate of the current fair value of each investment in our portfolio. Any changes in estimated 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 September 30, 2001, the Company had $924.5 million of outstanding indebtedness, bearing a weighted annual interest cost of 7.1%. In order for us to cover these annual interest payments on indebtedness, we must achieve annual returns on our assets of at least 2.9%.

Illustration. The following table illustrates the effect of leverage on returns from an investment in our common stock assuming various annual returns, net of expenses. The calculations in the table below are hypothetical and actual returns may be higher or lower than those appearing below.

Assumed Return on the Company s Portfolio

(net of expenses)

	-20%	-10%	-5%	0%	5%	10%	20%
Corresponding return to shareholder(1)	-40.0%	-22.5%	-13.8%	-5.1%	3.6%	12.3%	29.8%

(1) The calculation assumes (i) $2,266.8 million in total assets, (ii) an average cost of funds of 7.1%, (iii) $924.5 million in debt outstanding and (iv) $1,300.2 million of shareholders equity.

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 September 30, 2001, our asset coverage for senior indebtedness was 255%.

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.

Loss of Pass-Through Tax Treatment Would Substantially Reduce Net Assets and Income Available for Dividends. We have operated the Company so as to qualify to be taxed as a RIC under Subchapter M of the Internal Revenue Code of 1986, as amended (Code). If we meet source of income, diversification and distribution requirements, the Company qualifies for effective pass-through tax treatment. The Company would cease to qualify for such pass-through tax treatment if it were unable to comply with these requirements, 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 as a RIC. If the Company ceased 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.

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 and fee income earned, variation in timing of prepayments, variations in and the timing of the recognition of realized and unrealized gains or losses, the degree to which we encounter competition in our markets and general economic conditions.

Disclosure Regarding Forward-Looking Statements

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

THE COMPANY

Allied Capital is principally engaged in lending to and investing in private and undervalued public companies. The Company is organized in the state of Maryland and is an internally managed closed-end management investment company that has elected to be regulated as a business development company (as defined above, a BDC) under the 1940 Act.

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

USE OF PROCEEDS

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

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

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

PRICE RANGE OF COMMON STOCK AND DISTRIBUTIONS

Our common stock is traded on the New York Stock Exchange under the symbol ALD. The following table lists the high and low closing sales prices for the Company s common stock. On December 19, 2001, the last reported closing sale price of the common stock was $25.24 per share.

	Closing Sale Price(1)	
	High	**Low**
Year ended December 31, 1999		
First Quarter	$20.250	$16.500
Second Quarter	24.000	17.000
Third Quarter	23.813	20.250
Fourth Quarter	23.125	16.750
Year ended December 31, 2000		
First Quarter	$19.688	$16.063
Second Quarter	18.688	16.563
Third Quarter	21.125	17.438
Fourth Quarter	21.375	18.500
Year ending December 31, 2001		
First Quarter	$24.436	$20.125
Second Quarter	25.400	19.570
Third Quarter	24.830	21.500
Fourth Quarter (through December 19, 2001)	26.00	21.57

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

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

We pay quarterly dividends to stockholders of our common stock. The amount of our quarterly dividends is determined by the Board of Directors. The Company s Board has established a dividend policy to review the dividend rate quarterly and to adjust the quarterly dividend rate as the Company s earnings momentum builds. See Management s Discussion and Analysis of Financial Condition and Results of Operations Equity Capital and

Dividends and Tax Status. We cannot assure that we will achieve investment results or maintain a tax status that will permit any particular level of dividend payment.

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

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

MANAGEMENT S DISCUSSION AND ANALYSIS

OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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

OVERVIEW

The Company 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 September 30, 2001, and December 31, 2000, 1999 and 1998 was as follows:

	At September 30, 2001	At December 31, 2000	1999	1998
Private Finance	71%	72%	53%	48%
Commercial Real Estate Finance	29%	28%	42%	44%
Small Business Finance	%	%	5%	8%

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 and nine months ended September 30, 2001 and 2000 and as of and for the years ended December 31, 2000, 1999 and 1998 were as follows:

	At and for the Three Months Ended September 30,		At and for the Nine Months Ended September 30,		At and for the Years Ended December 31,		
($ in millions)	2001	2000	2001	2000	2000	1999	1998
Portfolio at Value	$2,174.4	$1,638.2	$2,174.4	$1,638.2	$1,788.0	$1,228.5	$807.1
Investments Funded	$209.5	$237.8	$509.6	$640.2	$901.5	$751.9	$524.5

Repayments
$7.9 $59.1 $52.0 $117.9 $154.1 $145.7 $138.0
Sales
$57.5 $34.7 $130.0 $151.8 $280.2 $198.4 $304.4
Yield
14.1% 13.9% 14.1% 13.9% 14.1% 13.0% 12.5%

Private Finance

Private finance investment activity and yields as of and for the three and nine months ended September 30, 2001 and 2000 and as of and for the years ended December 31, 2000, 1999 and 1998 were as follows:

($ in millions)	At and for the Three Months Ended Sept. 30,		At and for the Nine Months Ended Sept. 30,		At and for the Years Ended December 31,		
	2001	2000	2001	2000	2000	1999	1998
Portfolio at Value	$1,539.3	$967.5	$1,539.3	$967.5	$1,282.5	$647.0	$388.6
Investments Funded	$112.7	$148.5	$226.8	$387.6	$600.9	$346.7	$236.0
Repayments	$5.8	$49.6	$29.8	$88.8	$117.7	$87.5	$41.3
Yield	14.5%	14.6%	14.5%	14.6%	14.6%	14.2%	14.6%

The private finance portfolio increased 20% from December 31, 2000 to September 30, 2001, and increased 98% and 67% during the years ended December 31, 2000 and 1999, respectively. In addition to the $226.8 million of funded investments for the nine months ended September 30, 2001, the Company invested an additional $31.7 million in portfolio companies through receipt of payment in-kind securities. Buyout and private finance activity across the industry has been slow during the first nine months of 2001 largely due to credit tightening among senior lenders. Since equity-focused buyout firms generally need both senior and subordinated debt to leverage private equity investments, buyout activity has been reduced due to a lower level of activity in the senior bank market, and in particular the senior syndicated loan market. As a result, the Company s investment activity for the nine months ended September 30, 2001 has been at a slower pace than the comparable period for the prior year.

During the third quarter, the Company closed the controlled buyout of SunSource Inc. on September 26, 2001. Pursuant to the merger agreement signed on June 18, 2001, the Company paid $10.375 per SunSource common share, or $71.5 million, in cash for the outstanding common equity of SunSource. On September 28, 2001, SunSource announced that it completed the sale of its STS business unit. Pursuant to this sale, SunSource returned $15.0 million in cash to the Company, reducing the Company s cost basis. The Company s cost basis in the common stock of SunSource after the return of capital from the STS sale and the capitalization of deal costs was $58.6 million at September 30, 2001. The SunSource investment has been structured to provide for a current return to be earned through interest on debt and management/ consulting fees for services provided by the Company. In addition, during the third quarter of 2001, the Company earned investment banking fees of $2.8 million for the acquisition of SunSource and the sale of STS, earned a syndication fee of $1.6 million for the syndication of SunSource s senior credit facilities and realized a gain of $2.5 million from the sale of warrants in SunSource prior to the controlled buyout transaction. As part of the STS sale, the Company invested $3.2 million in the new STS.

The Company s increasing capital base has enabled it to make larger private finance investments, supporting the increase in originations in 2000, 1999 and 1998. Key investment characteristics for new private finance mezzanine investments were as follows:

	For the Years Ended December 31,		
	2000	1999	1998
New investment characteristics:			
Number of investments	34	27	19
Average investment size (millions)	$14.0	$12.4	$10.6
Average current yield	14.7%	13.6%	13.3%
Average portfolio company revenue (millions)	$153.5	$86.9	$81.3
Average portfolio company years in business	36	29	22

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%.

During 2000, the Company acquired BLC Financial Services, Inc. in a going private transaction, which thereafter changed its name to Business Loan Express, Inc. (BLX). The Company s investment in BLX is included in the private finance portfolio. See Small Business Finance discussion for more details below.

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 $0.4 million, $3.5 million and $7.0 million of this commitment for the three and nine months ended September 30, 2001 and for the year ended December 31, 2000, respectively.

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Commercial Real Estate Finance

Commercial real estate finance investment activity and yields as of and for the three and nine months ended September 30, 2001 and 2000 and as of and for the years ended December 31, 2000, 1999 and 1998 were as follows:

	At and for the Three Months Ended September 30,		At and for the Nine Months Ended September 30,		At and for the Years Ended December 31,		
($ in millions)	2001	2000	2001	2000	2000	1999	1998
Portfolio at Value	$635.1	$600.0	$635.1	$600.0	$505.5	$520.0	$355.0
Investments Funded	$96.8	$52.6	$282.8	$143.7	$149.0	$288.7	$214.6
Repayments	$2.1	$6.5	$22.2	$20.8	$24.8	$51.5	$92.5
Sales	$57.5	$1.6	$130.0	$53.1	$151.7	$86.1	$256.9
Yield	13.5%	13.2%	13.5%	13.2%	13.1%	12.3%	10.4%

The commercial real estate finance portfolio increased 26% from December 31, 2000 to September 30, 2001, and decreased 3% and increased 46% for the years ended December 31, 2000 and 1999, respectively. 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 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.

The Company purchases CMBS at an approximate discount of 50% from the face amount of the bonds. During the third quarter of 2001, the Company purchased $96.8 million in CMBS with a face value of $171.1 million and a weighted average yield to maturity of 15.0% after assuming a 1% loss rate on the underlying collateral mortgage pool. During the nine months ended September 30, 2001 the Company purchased $256.1 million in CMBS with a face value of $449.0 million. During the first quarter of 2001, the Company also purchased $24.6 million in non-investment grade securities related to a collateralized debt issuance secured by CMBS and investment grade real estate investment trust bonds. The weighted average yield to maturity on purchases made during the first nine months of 2001 is 15.0% after assuming a 1% loss rate on the underlying collateral mortgage pool. During 2000 and 1999, the Company purchased $124.3 million and $245.9 million in CMBS with a face amount of $244.6 million and $507.9 million and a weighted average yield to maturity of 14.7% and 14.6% after assuming a 1% loss rate on the underlying collateral mortgage pool, respectively.

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

the first nine months of 2001 and the fourth quarter of 2000 totaling $55.6 million, $124.5 million and $98.7 million, respectively. These bonds had an effective yield of 10.4%, 10.3% and 11.5%, and were sold for $56.7 million, $126.8 million and $102.5 million, respectively, resulting in realized gains on the sales. 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 September 30, 2001 was 15.2%, after assuming a 1% loss on the entire underlying mortgage loan pool. At September 30, 2001 and December 31, 2000 and 1999, the value of the purchased CMBS portfolio was $472.1 million, $311.3 million and $277.7 million and the unamortized discount was $510.3 million, $364.9 million and $291.5 million, respectively.

The original principal balance of the underlying pool of the approximately 3,300 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%	$2,060.4	11%
60-65%	1,663.9	9%
65-70%	2,834.0	16%
70-75%	5,838.7	33%
75-80%	5,332.0	30%
Greater than 80%	214.3	1%
	$17,943.3	100%
Weighted average LTV	69.7%	

Debt Service Coverage Ratio Ranges	$ ($ in millions)	%
Greater than 2.00	$556.6	3%
1.76-2.00	551.8	3%
1.51-1.75	2,046.3	11%
1.26-1.50	10,393.0	58%

1.00-1.25	4,395.6	25%
	$17,943.3	100%
Weighted average DSCR	1.40	

The Company has been liquidating much of its whole commercial mortgage loan portfolio so that it can redeploy the proceeds into higher yielding assets and for the three and nine months ended September 30, 2001, the Company sold $1.9 million and $7.6 million, respectively of commercial mortgage loans. For the years ended December 31, 2000 and 1999, the Company sold $53.1 million and $86.1 million of commercial mortgage loans, respectively. At September 30, 2001, the Company s whole commercial real estate loan portfolio had been reduced to $86.2 million from $106.4 million at December 31, 2000.

During 1998, the Company sold through securitization approximately $295 million in lower yielding commercial mortgage loans and sold whole loans to third parties aggregating approximately $33.5 million.

Small Business Finance

On December 31, 2000, the Company acquired 95% of BLC Financial Services, Inc. in a going private buyout transaction for $95.2 million. The Company issued approximately 4.1 million shares, or $86.1 million of new equity, and paid $9.1 million in cash to acquire BLC, which is now 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. BLX is included in the private finance portfolio.

At September 30, 2001, BLX had a 3-year $117.5 million revolving credit facility (BLX Credit Facility), which was increased to $124.0 million in October 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 September 30, 2001 was $50.3 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 September 30, 2001.

Prior to its contribution to BLX, Allied Capital Express loan activity and yields as of and for the years ended December 31, 2000, 1999 and 1998 were as follows:

($ in millions)	2000	1999	1998
Portfolio at Value	$	$61.4	$63.6
New Investments	$151.6	$116.5	$73.9
Repayments	$11.6	$6.7	$4.2
Sales	$128.5	$112.3	$47.5
Yield		11.5%	11.2%

Allied Capital Express loan origination activity for 2000 and 1999 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.

RESULTS OF OPERATIONS

Comparison of Nine Months Ended September 30, 2001 and 2000

The following table summarizes Allied Capital s operating results for the nine months ended September 30, 2001 and 2000.

($ in thousands, except per share amounts)	For the Nine Months Ended September 30, 2001	2000	Change	Percent Change
Interest and Related Portfolio Income				
Interest and dividends	$173,722	$129,768	$43,954	34%
Premiums from loan dispositions	2,070	10,752	(8,682)	(81%)
Fees and other income	30,652	9,334	21,318	228%
Total interest and related portfolio income	206,444	149,854	56,590	38%
Expenses				
Interest	47,974	41,645	6,329	15%
Employee	22,269	19,506	2,763	14%
Administrative	10,166	10,711	(545)	(5%)

Total operating expenses	80,409	71,862	8,547	12%
Net operating income before net realized and unrealized gains	126,035	77,992	48,043	62%
Net Realized and Unrealized Gains				
Net realized gains	8,339	23,095	(14,756)	(64%)
Net unrealized gains	23,463	(267)	23,730	8,888%
Total net realized and unrealized gains	31,802	22,828	8,974	39%
Net increase in net assets resulting from operations	$157,837	$100,820	$57,017	57%

Diluted net operating income per share	$1.39	$1.10	$0.29	26%
Diluted earnings per share	$1.74	$1.42	$0.32	23%
Weighted average shares outstanding diluted	90,864	70,777	20,087	28%

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

($ in millions, except per share amounts)	For the Nine Months Ended September 30, 2001	2000
Total Interest and Related Portfolio Income	$206.4	$149.9
Per share	$2.27	$2.11

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 17% to $1,732.0 million at September 30, 2001 from $1,485.0 million at September 30, 2000. The weighted average yield on the interest bearing investments in the portfolio at September 30, 2001 and 2000 was as follows:

	September 30, 2001	2000
Private Finance	14.5%	14.6%
Commercial Real Estate Finance	13.5%	13.2%
Small Business Finance	%	12.3%
Total Portfolio	14.1%	13.9%

Included in premiums from loan dispositions are premiums from loan sales and premiums received on the early repayment of loans. Premiums from loan sales were $0.5 million and $8.7 million for the nine months ended September 30, 2001 and 2000, respectively. Premium income results from the premium paid by purchasers on loans sold less the origination commissions associated with the loans sold. For the nine months ended September 30, 2000, premiums from loan sales resulted primarily from the sale of loans originated through Allied Capital Express. 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 $1.6 million and $2.1 million for the nine months ended September 30, 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.

Fees and other income include diligence, financial structuring, management and guaranty fees of $29.7 million and $5.4 million for the nine months ended September 30, 2001 and 2000, respectively. Fees and other income for the nine months ended September 30, 2001 include fees earned from the SunSource buyout transaction totaling

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$4.4 million discussed above. The Company continues to emphasize new financial structuring, diligence and portfolio management activity that generates additional fee income. Because individual fees for any one activity can vary in size, fee income may vary substantially 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 nine months ended September 30, 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 Nine Months Ended September 30,	
($ in millions)	**2001**	**2000**
Total Outstanding Debt	$924.5	$762.2
Average Outstanding Debt	$821.9	$684.3
Weighted Average Cost	7.1%	8.1%
BDC Asset Coverage*	255%	236%

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

Employee expenses include salaries, employee benefits and formula and cut-off awards. The increase in salaries and employee benefits for the periods presented reflects wage increases and the experience level of employees hired. Total employees were 95 and 136 at September 30, 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 employees dedicated to Allied Capital Express are reflected in employee expense for the nine months ended September 30, 2000. The formula and cut-off awards totaled $4.8 million for the nine months ended September 30, 2000. The formula award vested over a three-year period which ended on December 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. Administrative expenses for the nine months ended September 30, 2000 included expenses related to Allied Capital Express regional offices. The cost of these regional offices was transferred to BLX at the beginning of 2001. For the nine months ended September 30, 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 17% and 19%, respectively.

Net realized gains resulted from the sale of equity securities associated with certain private finance investments and the realization of unamortized discount resulting from the sale and early repayment of private finance loans, commercial mortgage loans and

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

($ in millions)	For the Nine Months Ended September 30, 2001	2000
Realized Gains	$9.9	$24.7
Realized Losses	(1.6)	(1.6)
Net Realized Gains	$8.3	$23.1
Net Unrealized Gains	$23.5	$(0.3)

Realized gains for the nine months ended September 30, 2001 primarily resulted from transactions involving three private finance portfolio companies, FTI Consulting, Inc. ($4.6 million), SunSource Inc. ($2.5 million) as discussed above, and Southwest PCS, LLC ($0.8 million), and the sale of Purchased CMBS BB bonds ($1.7 million). Realized gains for the nine months ended September 30, 2000 resulted primarily from transactions involving seven portfolio companies. The Company reversed previously recorded unrealized appreciation totaling $3.8 million and $6.2 million when gains were realized for the nine months ended September 30, 2001 and 2000, respectively.

Realized losses for the nine months ended September 30, 2001 and 2000 resulted from the continued liquidation of the Company s whole loan commercial real estate portfolio, as well as other small losses in the private finance portfolio. The Company reversed previously recorded unrealized depreciation totaling $1.5 million and $1.3 million when the related losses were realized in the nine months ended September 30, 2001 and 2000, respectively.

Net unrealized gains for the nine months ended September 30, 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 and $28.3 million at March 31, 2001 and September 30, 2001, 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 $11.3 million in total for the nine months ended September 30, 2001. These companies increased in value because of continued positive performance, and valuation data that would indicate that a valuation increase was necessary.

During the nine months ended September 30, 2001, the Company reversed previously recorded unrealized appreciation totaling $8.9 million on investments that the Company believed required adjustment based upon the portfolio company s performance in a weaker economy or a lower valuation multiple at which these companies would be expected to be sold in today s economy.

During the nine months ended September 30, 2001, the Company decreased the value of its common equity investments in Startec Global Communications Corporation by $3.0 million at March 31, 2001, and decreased the value of its debt investment in NETtel Communications, Inc. by $5.0 million at March 31, 2001 and $2.0 million at September 30, 2001. In addition, the Company decreased the value of other portfolio companies by a total of $19.2 million for the nine months ended September 30, 2001.

At September 30, 2001, net unrealized appreciation in the portfolio totaled $42.8 million and was composed of unrealized appreciation of $99.1 million, resulting primarily from appreciated equity interests in portfolio companies, and unrealized depreciation of $56.3 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 September 30, 2001, the Company s portfolio was graded as follows:

Grade	Portfolio at Value	Percentage of Total Portfolio
	(in millions)	
1	$479.4	22.1%
2	1,561.7	71.8%
3	57.3	2.6%
4	48.0	2.2%
5	28.0	1.3%
	$2,174.4	100.0%

Grade 5 private finance investments at September 30, 2001, totaled $26.0 million, at value, or 1.2%, of the Company s total portfolio. Total Grade 4 and 5 assets as a percentage of the total portfolio at value at September 30, 2001 and December 31, 2000 and 1999 were 3.5%, 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 September 30, 2001, delinquencies in the underlying collateral pool for the Company s CMBS portfolio were 0.30%. The yield used to accrue interest on this portfolio assumes a 1% loss rate on the entire underlying collateral mortgage pool, and as of

September 30, 2001, no losses have been realized. The Company has been closely monitoring the performance of all of the loans in the underlying collateral pools securing its CMBS investments since September 11, 2001, particularly the hospitality properties which constitute 7% of the collateral loans. The Company has surveyed and analyzed the performance of the hotel properties and has currently determined that an increase in delinquencies for this property type should be expected in the near term. The Company will continue to closely monitor this asset class as well as all of the loans securing its CMBS investments. The Company believes that the current performance of the underlying loans would not require an adjustment to its yield assumptions, but these assumptions will continue to be monitored and adjusted in the future, if necessary.

For the total investment portfolio, loans greater than 120 days delinquent were $61.6 million at value at September 30, 2001, or 2.8% of the total portfolio. Included in this category are loans valued at $10.4 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) continue to qualify as a BDC; (2) derive at least 90% of its gross income from dividends, interest, gains from the sale of securities and other specified types of income; (3) meet investment diversification requirements as defined in the Code; and (4) distribute annually to shareholders at least 90% of its investment company taxable income as defined in the Code. The Company intends to take all steps necessary to continue to meet the RIC qualifications. However, there can be no assurance that the Company will continue to qualify for such treatment in future years.

The weighted average common shares outstanding used to compute basic earnings per share were 89.3 million and 70.6 million for the nine months ended September 30, 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 90.9 million and 70.8 million for the nine months ended September 30, 2001 and 2000, respectively.

RESULTS OF OPERATIONS

Comparison of the Years Ended December 31, 2000, 1999 and 1998

The following table summarizes the Company s operating results for the years ended December 31, 2000, 1999 and 1998:

	2000	1999	Change	Percent Change	1999	1998	Change	Percent Change
	(in thousands, except per share amounts)							
Interest and Related Portfolio Income								
Interest and dividends	$182,307	$121,112	$61,195	51%	$121,112	$80,281	$40,831	51%
Premiums from loan dispositions	16,138	14,284	1,854	13%	14,284	5,949	8,335	140%
Post-Merger gain on securitization of commercial mortgage loans				0%		14,812	(14,812)	(100%)
Fees and other income	13,144	5,744	7,400	129%	5,744	5,696	48	1%
Total interest and related portfolio income	211,589	141,140	70,449	50%	141,140	106,738	34,402	32%

Expenses

Interest								
	57,412	34,860	22,552	65%	34,860	20,694	14,166	68%
Employee								
	19,842	16,136	3,706	23%	16,136	11,829	4,307	36%
Administrative								
	15,435	12,350	3,085	25%	12,350	11,921	429	4%
Total operating expenses								
	92,689	63,346	29,343	46%	63,346	44,444	18,902	43%
Formula and cut-off awards								
	6,183	6,753	(570)	(8%)	6,753	7,049	(296)	(4%)

Net operating income before net realized and unrealized gains	112,717	71,041	41,676	59%	71,041	55,245	15,796	29%

Net Realized and Unrealized Gains

Net realized gains	15,523	25,391	(9,868)	(39%)	25,391	22,541	2,850	13%
Net unrealized gains	14,861	2,138	12,723	595%	2,138	1,079	1,059	98%
Total net realized and unrealized gains	30,384	27,529	2,855	10%	27,529	23,620	3,909	17%

Income before income taxes	143,101	98,570	44,531	45%	98,570	78,865	19,705	25%
Income tax expense				0%		787	(787)	(100%)
Net increase in net assets resulting from operations	$143,101	$98,570	$44,531	45%	$98,570	$78,078	$20,492	26%
Diluted net operating income per share	$1.53	$1.18	$0.35	30%	$1.18	$1.06	$0.12	11%

Diluted earnings per share	$1.94	$1.64	$0.30	18%	$1.64	$1.50	$0.14	9%
Weighted average shares outstanding diluted	73,472	60,044	13,428	22%	60,044	51,974	8,070	16%

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

	2000	1999	1998
	(in millions, except per share amounts)		
Total Interest and Related Portfolio Income	$211.6	$141.1	$106.7
Per share	$2.88	$2.35	$2.05

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 29% to $1,471.8 million at December 31, 2000 from $1,141.2 million at December 31, 1999, and increased by 51% during 1999 from $757.7 million at December 31, 1998. The weighted average yield on the interest bearing investments in the portfolio at December 31, 2000, 1999 and 1998 was as follows:

	2000	1999	1998
Private Finance	14.6%	14.2%	14.6%
Commercial Real Estate Finance	13.1%	12.3%	10.4%
Small Business Finance		11.5%	11.2%
Total Portfolio	14.1%	13.0%	12.5%

Included in net premiums from loan dispositions are premiums from loan sales and premiums received on the early repayment of loans. Premiums from loan sales were $13.3 million, $10.5 million and $3.8 million for the years ended December 31, 2000, 1999 and 1998, respectively. This premium income results primarily from the premium paid by purchasers of loans originated through Allied Capital Express, less the origination commissions associated with the loans sold. In addition to selling the guaranteed portion of the SBA 7(a) loans, 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. The 176% increase in premiums from loan sales in 1999 is primarily the result of a significant increase in the sale of the guaranteed SBA 7(a) loans and unguaranteed portions of SBA 7(a) loans. SBA 7(a) loan sales were $101.0 million, $93.7 million and $37.0 million for the years ended December 31, 2000, 1999 and 1998, respectively. 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 management contract with BLX.

Prepayment premiums were $2.8 million, $3.8 million and $2.2 million for the years ended December 31, 2000, 1999 and 1998, 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.

Total interest and related portfolio income for 1998 includes a one-time gain on sale of $14.8 million resulting from a commercial mortgage loan securitization transaction that was completed in January 1998. Excluding the 1998 gain on sale, total interest and related portfolio income increased for the year ended December 31, 1999 by 53% as compared to the year ended December 31, 1998. The proceeds of $238.4 million from this transaction were used to repay outstanding debt.

Operating expenses include interest, employee and administrative expenses. The Company s single largest expense is interest on indebtedness. The fluctuations in interest expense during 2000, 1999 and 1998 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:

	2000	1999	1998
	($ in millions)		
Total Outstanding Debt	$786.6	$592.9	$334.4
Average Outstanding Debt	$707.4	$461.5	$261.3
Weighted Average Cost	8.3%	7.9%	7.5%
BDC Asset Coverage*	245%	228%	273%

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

Employee expenses include salaries, employee benefits and formula and cut-off awards. The increase in salaries and employee benefits for the periods presented reflects the increase in total employees, combined with wage increases and the experience level of employees hired. Total employees were 97, 129 and 106 at December 31, 2000, 1999 and 1998, respectively. As part of the recapitalization of Allied Capital Express discussed above, 37 employees of the Company were transferred to the portfolio company at the end of 2000. Expenses related to these employees are reflected in employee expense for the year. The formula and cut-off awards totaled $6.2 million, $6.8 million and $7.0 million for the years ended December 31, 2000, 1999 and 1998, respectively.

The formula award expense totaled $5.7 million, $6.2 million and $6.2 million for the years ended December 31, 2000, 1999 and 1998, respectively. The formula award was designed as an incentive compensation program that would replace canceled stock options that were canceled as a result of the Company s 1997 Merger and would balance share ownership among key officers. The formula award vested over a three-year period, on the anniversary date of the Merger, beginning on December 31, 1998.

The cut-off award expense totaled $0.5 million, $0.6 million and $0.8 million for the years ended December 31, 2000, 1999 and 1998, respectively. 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 will only be payable if the award recipient is employed by the Company on a future vesting date.

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 years ended December 31, 2000, 1999 and 1998, employee and administrative costs as a percentage of total interest and related portfolio income less interest expense plus net realized and unrealized gains was 19%, 21% and 22%, respectively.

Net realized gains resulted from the sale of equity securities associated with certain private finance investments and the realization of unamortized discount resulting from the sale and early repayment of private finance loans, commercial mortgage loans and Purchased CMBS bonds, offset by losses on investments. Realized gains and losses and net unrealized gains for the years ended December 31, 2000, 1999 and 1998 were as follows:

	2000	1999	1998
	(in millions)		
Realized Gains	$28.6	$31.5	$25.8
Realized Losses	(13.1)	(6.1)	(3.3)
Net Realized Gains	$15.5	$25.4	$22.5
Net Unrealized Gains	$14.9	$2.1	$1.1

Realized gains during 2000 resulted primarily from transactions involving eight investments Southwest PCS, L.P. ($11.5 million), Grant Television, Inc. ($5.4 million), CMBS bonds sold ($3.9 million), Julius Koch USA, Inc. ($1.7 million), Wilmar Industries, Inc. ($1.2 million), Hotelevision ($1.0 million), FTI Consulting, Inc. ($0.7 million) and Panera Bread Co. ($0.7 million). The Company reversed previously recorded unrealized appreciation of $7.5 million when these gains were realized in 2000. Realized gains in 1999 and 1998 resulted primarily from transactions involving 6 and 10 portfolio companies, and the Company reversed previously recorded unrealized appreciation of $14.6 million and $8.1 million, respectively, when these gains were realized.

Realized losses in 2000, 1999 and 1998 represented 0.7%, 0.5% and 0.4% of the Company s total assets, respectively. Realized losses of $13.1 million during 2000 resulted primarily from two portfolio investments NETtel Communications, Inc. ($8.5 million) and Total Foam, Inc. ($1.3 million). The remaining losses consisted of several losses of less than $0.5 million each. Losses realized in 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 $12.0 million, $5.4 million and $3.6 million when the related losses were realized in 2000, 1999 and 1998, respectively.

Net unrealized gains for 2000, 1999 and 1998 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. At December 31, 2000, net unrealized appreciation in the portfolio totaled $19.4 million and was composed of unrealized appreciation of $49.1 million, resulting primarily from appreciated equity interests in portfolio investments, and unrealized depreciation of $29.7 million resulting primarily from underperforming loan and equity interests in the portfolio. At December 31, 1999 and 1998, net unrealized appreciation in the portfolio totaled $4.5 million and $2.4 million, respectively, and was composed of unrealized appreciation of $32.1 million and $27.3 million, and unrealized depreciation of $27.6 million and $24.9 million, respectively.

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

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

Grade	Portfolio at Value	Percentage of Total Portfolio
	($ in millions)	
1	$208.3	11.7%
2	1,461.7	81.7%
3	15.4	0.9%
4	76.0	4.2%
5	26.6	1.5%
	$1,788.0	100.0%

Included in Grade 4 and 5 investments are assets totaling $20.5 million and $10.6 million that are secured by commercial real estate at December 31, 2000 and 1999, respectively. Grade 5 private finance investments at December 31, 2000 and 1999 totaled $18.7 million and $12.6 million at value, or 1.0% and 1.0% of the Company s total portfolio, respectively. 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 December 31, 2000, delinquencies in the underlying collateral pool for the Company s CMBS portfolio were 0.38%. The yield used to accrue interest on this portfolio assumes a 1% loss rate on the entire underlying collateral mortgage pool.

For the total investment portfolio, loans greater than 120 days delinquent were $56.4 million at value at December 31, 2000, or 3.2% of the total portfolio. Included in this category are loans valued at $13.3 million that are fully secured by commercial real estate. Loans greater than 120 days delinquent at December 31, 1999 were $18.6 million at value, or 1.5% of the total portfolio, which included $11.7 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 weighted average common shares outstanding used to compute basic earnings per share were 73.2 million, 59.9 million and 51.9 million for the years ended December 31, 2000, 1999 and 1998, 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 73.5 million, 60.0 million and 52.0 million for the years ended December 31, 2000, 1999 and 1998, respectively.

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

Cash and Cash Equivalents

At September 30, 2001, the Company had $3.1 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 September 30, 2001 as follows:

($ in millions)	Facility Amount	Amount Outstanding	Annual Interest Cost(1)	Annual Portfolio Return to Cover Interest Payments(2)
Notes payable and debentures:				
Unsecured long-term notes	$544.0	$544.0	7.9%	1.9%
SBA debentures	101.8	87.0	8.0%	0.3%
Auction rate reset note	80.8	80.8	5.4%	0.2%
OPIC loan	5.7	5.7	6.6%	0.0%
Total notes payable and debentures	$732.3	$717.5	7.6%	2.4%

Revolving credit facilities:				
Revolving line of credit	467.5	207.0	5.5%	0.5%
Total debt	$1,199.8	$924.5	7.1%	2.9%

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

(2) The annual portfolio return to cover interest payments is calculated as the September 30, 2001 annualized cost of debt per class of financing divided by total assets at September 30, 2001.

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

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

SBA Debentures. The Company, through its SBIC subsidiary, has debentures payable to the SBA with terms of ten years. The notes require payment of interest only semi-annually, and all principal is due upon maturity. The Company may currently borrow up to $101.8 million from the SBA under the SBIC program. At September 30, 2001, the

Company has a commitment to borrow up to an additional $14.8 million above the amount outstanding from the SBA. The commitment expires on September 30, 2005.

Auction Rate Reset Note. The Company has a $80.8 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 $80.8 million of debt, equity or other securities in one or more public or private transactions, or prepay the Auction Rate Reset Note, on or before August 31, 2002. If the note is prepaid, the Company will pay a fee equal to 0.5% of the aggregate amount of the note outstanding.

Revolving Line of Credit. As of September 30, 2001, the Company has a $467.5 million unsecured revolving line of credit that expires in August 2003 with the right to extend maturity for one additional year at the Company s sole option, under substantially similar terms. This facility may be expanded up to $600 million. 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 nine months ended September 30, 2001, the Company raised $237.0 million in new equity capital primarily through the sale of shares from its shelf registration statement. The Company issues equity from time to time 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 September 30, 2001, total shareholders equity had increased to $1.3 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, second and third quarter of 2001, the Board declared a $0.49, $0.50 and $0.51 per common share dividend, respectively. For the fourth quarter of 2001, the Board has declared a dividend of $0.51 per common share. Dividends are paid from the Company s taxable income.

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

The Company plans to maintain a strategy of financing its operations, dividend requirements and future investments with cash from operations, through borrowings under short- or long-term credit facilities or other debt securities, through asset sales, or through the sale or issuance of new equity capital. The Company maintains a matched-funding philosophy that focuses on matching the estimated maturities of its loan and investment portfolio to the estimated maturities of its borrowings. The Company will utilize its short-term credit facilities only as a means to bridge to long-term financing, which may result in temporary differences in the matching of estimated maturities. The Company evaluates its interest rate exposure on an ongoing basis. To the extent deemed necessary, the Company may hedge variable and short-term interest rate exposure through interest rate swaps or other techniques. At September 30, 2001, the Company s debt to equity ratio was 0.71 to 1 and weighted average cost of funds was 7.1%. There are no significant maturities of long-term debt until 2003. The Company believes that it has access to capital sufficient to fund its ongoing investment and operating activities, and from which to pay dividends.

SENIOR SECURITIES

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

Class and Year	Total Amount Outstanding Exclusive of Treasury Securities(1)	Asset Coverage Per Unit(2)	Involuntary Liquidating Preference Per Unit(3)	Average Market Value Per Unit(4)
Unsecured Long-term Notes Payable				
1991	$0	$0	$	N/A
1992	0	0		N/A
1993	0	0		N/A
1994	0	0		N/A
1995	0	0		N/A
1996	0	0		N/A
1997	0	0		N/A
1998	180,000,000	2,734		N/A
1999	419,000,000	2,283		N/A
2000	544,000,000	2,445		N/A
2001 (as of September 30, unaudited)	544,000,000	2,545		N/A
SBA Debentures(5)				
1991	$49,800,000	$3,834	$	N/A
1992	49,800,000	5,789		N/A
1993	49,800,000	6,013		N/A
1994	54,800,000	3,695		N/A
1995	61,300,000	2,868		N/A
1996	61,300,000	2,485		N/A
1997	54,300,000	2,215		N/A
1998	47,650,000	2,734		N/A
1999	62,650,000	2,283		N/A
2000	78,350,000	2,445		N/A

2001 (as of September 30, unaudited)			
87,000,000	2,545		N/A

Auction Rate Reset Note

1991			
$0	$0	$	N/A
1992			
0	0		N/A
1993			
0	0		N/A
1994			
0	0		N/A
1995			
0	0		N/A
1996			
0	0		N/A
1997			
0	0		N/A
1998			
0	0		N/A
1999			
0	0		N/A
2000			
76,598,000	2,445		N/A
2001 (as of September 30, unaudited)			
80,784,000	2,545		N/A

Class and Year	Total Amount Outstanding Exclusive of Treasury Securities(1)	Asset Coverage Per Unit(2)	Involuntary Liquidating Preference Per Unit(3)	Average Market Value Per Unit(4)
Overseas Private Investment Corporation Loan				
1991	$0	$0	$	N/A
1992	0	0		N/A
1993	0	0		N/A
1994	0	0		N/A
1995	0	0		N/A
1996	8,700,000	2,485		N/A
1997	8,700,000	2,215		N/A
1998	5,700,000	2,734		N/A
1999	5,700,000	2,283		N/A
2000	5,700,000	2,445		N/A
2001 (as of September 30, unaudited)	5,700,000	2,545		N/A
Revolving Lines of Credit				
1991	$0	$0	$	N/A
1992	0	0		N/A
1993	0	0		N/A
1994	32,226,000	3,695		N/A
1995	20,414,000	2,868		N/A
1996	45,099,000	2,485		N/A
1997	38,842,000	2,215		N/A
1998	95,000,000	2,734		N/A
1999	82,000,000	2,283		N/A
2000	82,000,000	2,445		N/A
2001 (as of September 30, unaudited)	207,000,000	2,545		N/A
Master Repurchase Agreement and Master Loan and Security Agreement				

1991			
$0	$0	$	N/A
1992			
0	0		N/A
1993			
0	0		N/A
1994			
23,210,000	3,695		N/A
1995			
0	0		N/A
1996			
85,775,000	2,485		N/A
1997			
225,821,000	2,215		N/A
1998			
6,000,000	2,734		N/A
1999			
23,500,000	2,283		N/A
2000			
0	0		N/A
2001 (as of September 30, unaudited)			
0	0		N/A

Class and Year	Total Amount Outstanding Exclusive of Treasury Securities(1)	Asset Coverage Per Unit(2)	Involuntary Liquidating Preference Per Unit(3)	Average Market Value Per Unit(4)
Senior Note Payable(6)				
1991	$0	$0	$	N/A
1992	20,000,000	5,789		N/A
1993	20,000,000	6,013		N/A
1994	20,000,000	3,695		N/A
1995	20,000,000	2,868		N/A
1996	20,000,000	2,485		N/A
1997	20,000,000	2,215		N/A
1998	0	0		N/A
1999	0	0		N/A
2000	0	0		N/A
2001 (as of September 30, unaudited)	0	0		N/A
Bonds Payable				
1991	$0	$0	$	N/A
1992	0	0		N/A
1993	0	0		N/A
1994	0	0		N/A
1995	98,625,000	2,868		N/A
1996	54,123,000	2,485		N/A
1997	0	0		N/A
1998	0	0		N/A
1999	0	0		N/A
2000	0	0		N/A
2001 (as of September 30, unaudited)	0	0		N/A
Reverse Repurchase Agreements(7)				
1991	$2,761,000	$3,834	$	N/A
1992	0	0		N/A
1993				

	0	0	N/A
1994			
	0	0	N/A
1995			
	0	0	N/A
1996			
	0	0	N/A
1997			
	0	0	N/A
1998			
	0	0	N/A
1999			
	0	0	N/A
2000			
	0	0	N/A
2001 (as of September 30, unaudited)			
	0	0	N/A

Class and Year	Total Amount Outstanding Exclusive of Treasury Securities(1)	Asset Coverage Per Unit(2)	Involuntary Liquidating Preference Per Unit(3)	Average Market Value Per Unit(4)
Redeemable Cumulative Preferred Stock(5)				
1991	$1,000,000	$338	$100	N/A
1992	1,000,000	526	100	N/A
1993	1,000,000	546	100	N/A
1994	1,000,000	351	100	N/A
1995	1,000,000	277	100	N/A
1996	1,000,000	242	100	N/A
1997	1,000,000	217	100	N/A
1998	1,000,000	267	100	N/A
1999	1,000,000	225	100	N/A
2000	1,000,000	242	100	N/A
2001 (as of September 30, unaudited)	1,000,000	252	100	N/A
Non-Redeemable Cumulative Preferred Stock(5)				
1991	$6,000,000	$338	$100	N/A
1992	6,000,000	526	100	N/A
1993	6,000,000	546	100	N/A
1994	6,000,000	351	100	N/A
1995	6,000,000	277	100	N/A
1996	6,000,000	242	100	N/A
1997	6,000,000	217	100	N/A
1998	6,000,000	267	100	N/A
1999	6,000,000	225	100	N/A
2000	6,000,000	242	100	N/A
2001 (as of September 30, unaudited)	6,000,000	252	100	N/A

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

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

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

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

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

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

(7) U.S. government agency guaranteed loans sold under agreements to repurchase. The Company was advised by the Staff of the Commission that these reverse repurchase agreements were not considered a class of senior security representing indebtedness and thus were not subject to the asset coverage requirements of the 1940 Act.

BUSINESS

As a business development company, we provide private investment capital to private companies and undervalued public companies in a variety of different industries and in diverse geographic locations throughout the United States. We have been investing in growing businesses for over 40 years and have financed thousands of private companies nationwide. Today, our investment activity is focused in two areas:

Private finance and

Commercial real estate finance, primarily the purchase of CMBS.

Our investment portfolio consists primarily of long-term unsecured loans with equity features, equity investments in middle-market companies, which may or may not constitute a controlling equity interest, commercial mortgage-backed securities, and commercial mortgage loans. At September 30, 2001, our investment portfolio totaled $2.2 billion. Our investment objective is to achieve current income and capital gains.

Private Finance

We provide long-term debt and equity financing to private companies nationwide. Our core private finance activities target a market niche between the senior debt financing provided by traditional lenders, such as banks, commercial finance companies and insurance companies, and the equity capital provided by private equity investors. These types of investments are commonly referred to as mezzanine investments.

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

We primarily originate mezzanine investments generally ranging in size from $5 million to $35 million. Our private finance mezzanine investments are generally structured as an unsecured, subordinated loan that carries a relatively high fixed interest rate (generally 12% to 18%), with interest-only payments in the early years and payments of both principal and interest in the later years, with maturities of five to ten years. Approximately 97% of the loans and debt securities in the private finance portfolio have fixed rates of interest. Our private finance mezzanine investments typically include equity features, such as warrants or options to buy a minority interest in the portfolio company. We also make preferred and common equity investments, particularly when we see unique opportunities to profit from the growth of an emerging company. At September 30, 2001, 71% of the private finance portfolio consisted of loans and debt securities, and 29% consisted of equity securities. Our nationwide private finance portfolio includes investments in a wide variety of industries, including non-durable consumer products, business services, financial services, light industrial products, broadcasting and cable, and education.

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

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

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

Preferred and common equity Unsecured long- term debt with warrants

Preferred and common equity Equity

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

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

Banks are primarily focused on providing senior secured and unsecured short-term debt. They typically do not provide meaningful long-term unsecured loans. Commercial finance companies are primarily focused on providing senior secured long-term debt. The private placement and high-yield debt markets are focused primarily on very large financing transactions, typically in excess of the financings we do. We generally do not compete with banks, commercial finance companies, or the private placement/high yield market. Instead, we compete directly with the private mezzanine sector of the private equity market. Private mezzanine funds are also focused on providing unsecured long-term debt to private companies for the types of transactions discussed above. We believe that we have key structural and operational advantages when compared to private mezzanine funds.

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

We estimate that we fund approximately 2% of all the private finance investments that we review. When assessing a prospective investment, we look for a company that has achieved, or has the potential to achieve, market leadership in a niche, critical mass and longevity, and a sustainable cash flow. We also look for companies that, because of their industry and business plan, can demonstrate minimal vulnerability to changes in economic cycles. Since our debt securities are primarily unsecured in nature, we look for companies in industries that are less cyclical, cash flow intensive, and can demonstrate a high return on their invested capital. We generally do not target companies in industries where businesses tend to be vulnerable to changes in economic cycles, are capital intensive, and have low returns on their invested capital. We generally target and do not target the following industries, though we will consider investments in any industry if the prospective company demonstrates unique characteristics that make it an attractive investment opportunity:

Industries Targeted

Less Cyclical/Cash Flow Intensive/ High Return on Capital

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

Industries Not Targeted

Cyclical/Capital Intensive/ Low Return on Capital

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

Another critical element of our investment discipline is to invest in companies with a significant equity capital base, and a strong private equity sponsor. For example, in 2000, 75% of our core private mezzanine financings were completed in conjunction with private equity firms, which provided capital that is junior to ours. We believe strong equity sponsorship significantly strengthens our position as a long-term lender. A strong equity sponsor provides not only strong equity capital beneath our investment, but also provides a reliable source of additional equity capital if the portfolio company requires additional financing. Private equity sponsors also help us confirm our own due diligence findings when assessing a new investment opportunity, and they provide assistance and leadership to the portfolio company s management team throughout our investment period.

We target a total return of 18% to 25% for our private finance mezzanine investments. The typical private finance mezzanine structure focuses, first and foremost, on the protection of our investment principal. Our debt instruments generally provide for a contractual interest rate ranging from 12% to 18%, which provides current interest income. The debt instruments also have restrictive covenants that protect our interests in the transaction. The warrants we receive with our debt securities generally require only a minimal cost to exercise, and thus as the portfolio company appreciates in value, we achieve additional investment return from this equity interest. We seek to achieve additional investment returns of up to 10% from the appreciation and sale of our warrants.

Generally, our warrants expire five years after the related debt is repaid. The warrants typically include registration rights, which allow us to sell the securities if the portfolio company completes a public offering. In most cases, the warrants also have a put option that requires that the borrower repurchase our equity position after a specified period of time at a formula price or at its fair market value. Most of the gains we realize from our warrant portfolio arise as a result of the sale of the portfolio company to another business, or through a recapitalization. Historically, we have not been dependent on the public equity markets for the sale of our warrant positions. From time to time, we may also acquire preferred or common equity in a company as a part of our core private finance investing activities. Preferred equity investments may be structured with a dividend yield of up to 8% which would provide us with a current return. With respect to preferred or common equity investments, we target an investment return of 25% to 40%.

In addition to our primary core private finance mezzanine investment activities, from time-to-time we may acquire more than 50% of the common stock of a company in a control buyout transaction. In addition to our common equity investment, we may also provide additional capital to the controlled portfolio company in the form of senior loans, subordinated debt or preferred stock. The types of companies that we would acquire through a control buyout transaction are the same types of companies that we would invest in through our core mezzanine investment activities. In particular, we may see opportunities to acquire illiquid public companies and take them private. We intend to be selective about the companies in which we would acquire a controlling interest to ensure that we maintain a diversified portfolio with respect to industry types and geographic locations.

We generally structure our control investments such that we receive a current return through a combination of interest income on our senior loans and subordinated debt, dividends on our preferred and/or common stock, and/or a management/consulting fee to compensate us for the managerial assistance that we provide to a controlled portfolio company. For these types of investments, we target a current return of 12% to 17% on the total investment. In addition to the current return, we target an overall investment return on control investments of 25% to 40%.

When we acquire a controlling interest in a company, we may have the opportunity to acquire the company s equity with Allied Capital s common stock. The issuance of our stock as consideration provides us with the benefit of raising equity without having to access the public markets in an underwritten offering, including the added benefit of the elimination of any underwriter commissions.

As a BDC, we make managerial assistance available to the portfolio companies in which we invest. Therefore, in addition to the interest, dividend and management fee income received from our private finance investments, we may charge consulting, structuring or syndication fees to our portfolio companies in return for the financial and managerial services that we provide related to our borrowers debt and equity capital needs.

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

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

Commercial Real Estate Finance

Commercial Mortgage Loans. We have been a commercial real estate lender for many years, and maintain a small whole commercial mortgage loan portfolio. During 1998, we significantly reduced our middle-market commercial real estate lending activities because we believed that the market was under-pricing commercial real estate loans, and that the returns on senior commercial real estate loans were below a level that would result in a fair return on equity for our shareholders.

Since 1999, we have been liquidating a significant portion of our whole commercial mortgage loan portfolio. We believe that we can redeploy the proceeds into higher yielding investments. We continue to derive income from the interest charged on the whole commercial mortgage loan portfolio through contractual interest and amortization of discounts.

Commercial Mortgage-Backed Securities. The same pricing pressures that caused us to reduce our origination of commercial mortgage loans in 1998 created significant liquidity problems for many other real estate lenders who had remained active lenders as pricing declined throughout 1998. In the fourth quarter of 1998, many of these lenders experienced severe liquidity constraints that caused them to exit the commercial mortgage-backed securities market. This liquidity turmoil in the real estate capital markets created a unique opportunity for us to acquire newly issued, non-investment grade commercial mortgage-backed securities (Purchased CMBS) at significant discounts from the face amount of the bonds and at attractive yields.

As an investor, we believe that Purchased CMBS has attractive risk/return characteristics. The Purchased CMBS in which we invest are non-investment grade, which means that nationally recognized statistical rating organizations rate them below the top four investment-grade rating categories (i.e., AAA through BBB), and are sometimes referred to as junk bonds. Unlike most junk bonds, which are typically unsecured debt instruments, the non-investment grade Purchased CMBS in which we invest are secured by mortgage loans with real estate collateral. Our Purchased CMBS are fully collateralized by senior mortgage loans on commercial real estate properties where the loans are, on average, supported by a 30% equity investment. We acquire our Purchased CMBS on the initial issuance of the CMBS bond offering, and are able to underwrite and negotiate to purchase the securities at a significant discount from their face amount, generally resulting in an estimated yield to maturity ranging from 13% to 16%. Our negotiated discount and estimated yield to maturity assumes a 1% loss rate on the entire underlying commercial mortgage loan collateral pool, which takes into consideration certain business and economic uncertainties and contingencies. We find the yields for Purchased CMBS very attractive given their collateral protection.

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

As a non-investment grade CMBS investor, we recognize that non-investment grade securities have a higher degree of risk than do investment grade bonds. Non-investment grade securities are considered speculative, and their capacity to pay principal and interest in accordance with the terms of their issue is not ensured. They tend to be less liquid, may have a higher risk of default, and may be more difficult to value. We invest in non-investment grade CMBS represented by the BB to non-rated tranches of a CMBS issuance. Due to the underlying structure of the CMBS issuances, our CMBS tranches receive principal payments only after the securities that are senior to our securities are repaid. Thus, if losses are incurred in the underlying mortgage loan collateral pool, we would experience these losses.

To mitigate this risk, we perform extensive due diligence prior to an investment in Purchased CMBS. When we evaluate a CMBS investment, we use the same underwriting procedures and criteria for the mortgage loans in the collateral pool as we do for all of the loans we originate. These underwriting procedures and criteria are described in detail below. We will only invest in CMBS when we believe, as a result of our underwriting procedures, that the underlying mortgage pool adequately secures our position. Our portfolio of CMBS is secured by approximately 3,300 commercial real estate properties located in diverse geographic locations across the United States in a wide variety of property types, including retail, multi-family housing, office, and hospitality. See Management s Discussion and Analysis of Financial Condition and Results of Operations for a summary of the loan to value ratios and debt service coverage ratios of the mortgage loans securing our Purchased CMBS investments.

Our Purchased CMBS activity complements our private finance activity because it provides a steady stream of recurring interest income. In addition, given our depth of our commercial real estate experience and the extensive due diligence that we perform prior to an investment in Purchased CMBS, we may receive structuring and diligence fees upon the purchase of CMBS bonds. These fees are separately negotiated for each transaction. In order to maintain a balanced investment portfolio, we expect to limit our Purchased CMBS activity to approximately 20% to 25% of total assets.

Small Business Finance

On December 31, 2000, Allied Capital and BLC Financial Services, Inc. (BLC) completed a merger whereby Allied Capital acquired BLC. The effect of the merger was to create an independently managed, private portfolio company of Allied Capital to focus exclusively on small business lending, including the origination of SBA 7(a) loans. BLC changed its name to Business Loan Express, Inc. (BLX).

As part of this transaction, on December 28, 2000, we recapitalized our wholly owned small business lending subsidiary, Allied Capital SBLC Corporation, as an independently managed private portfolio company. Allied SBLC established a separate board of directors, and the employees and operations attributed to Allied Capital Express, including the online loan origination technology, were transferred to Allied SBLC. We restructured previous intercompany debt owed to us by Allied SBLC at the time of the recapitalization as $74.5 million in subordinated debt now owed by the new portfolio company. Allied SBLC was subsequently merged into BLX and we received $25.1 million in BLX preferred stock in exchange for our equity in Allied SBLC.

BLX is currently financed with a combination of senior and subordinated debt, and preferred and common equity. Allied Capital owns 94.9% of BLX. Allied Capital s investment in BLX is expected to generate interest income, dividends and fee income. In addition, we believe there is opportunity to add value to the new portfolio company and to position the investment for a future capital gain. The Company has entered into a management contract with BLX to provide management services, including certain technology and transition services. Our investment in BLX is included in our private finance portfolio.

BLX is a non-bank small business lender licensed as a participant in the SBA 7(a) Guaranteed Loan Program. BLX has a total of 31 offices nationwide, and SBA Preferred Lender status in 66 markets. BLX believes it will be a technology leader in online small business loan origination, and will have significant online loan origination relationships as well as solid core broker relationships in the small business community. BLX is licensed by the SBA as a Small Business Lending Company (SBLC), and therefore, changes in the laws or regulations that govern SBLCs could have a material impact on BLX or its operations.

Investment Advisory Services

We are a registered investment adviser, pursuant to the Investment Advisers Act of 1940, and have an investment advisory agreement to manage a private investment fund. The revenue generated from this agreement is not material to the Company s operations.

Loan Sourcing

We have established a business development group within Allied Capital that actively sources new investment opportunities. We maintain a network of hundreds of relationships with investors, lenders and intermediaries including:

- private mezzanine and equity investors;
- investment banks;
- business and mortgage brokers;
- national retail financial services companies; and
- banks, law firms and accountants.

We believe that our experience and reputation provide a competitive advantage in originating new investments. We have established an extensive network of investment referral relationships over our history. We are recognized as a pioneer in the private finance industry, and have developed a reputation in the commercial real estate finance market for our ability to finance complex transactions.

Investment Approval and Underwriting Procedures

In assessing new investment opportunities, we maintain conservative credit standards based on our underwriting guidelines, a thorough due diligence process, and a centralized credit approval process requiring committee review, all of which are described below. The combination of conservative underwriting standards and our credit-oriented culture has resulted in a record of minimal realized losses.

Private Finance. We generally require that the companies in which we invest demonstrate strong market position, sales growth, positive cash flow, and profitability, as discussed above. We emphasize the quality of management, and seek experienced entrepreneurs with a management track record, relevant industry experience and a significant equity stake in the business. In a typical private financing, we thoroughly review, analyze and substantiate, through due diligence, the business plan and operations of the potential portfolio company. We perform financial due diligence, often with assistance of an accounting firm; perform operational due diligence, often with the assistance of an industry consultant; study the industry and competitive landscape; and conduct numerous reference checks with current and former employees, customers, suppliers and competitors. The typical private finance transaction requires two to three months of diligence and structuring before funding occurs.

Private finance transactions are approved by an investment committee consisting of our most senior private finance professionals and chaired by our Chairman and Chief Executive Officer. The private finance approval process benefits from the experience of the investment committee members and from the experience of our other investment professionals who together with the committee members, on average, have over twelve years of professional experience. For every transaction of $10 million or greater, we also require approval from the Executive Committee of the Board of Directors in addition to the investment committee approval. Even after all such approvals are received, due diligence must be successfully completed with final investment committee approval before funds are disbursed to a portfolio company.

Purchased CMBS. We receive extensive packages of information regarding the mortgage loans comprising a CMBS pool. We work with the issuer, the investment bank, and the rating agencies in performing our diligence on a CMBS purchase. The typical CMBS purchase takes between two to three months to complete because of the breadth and depth of our diligence procedures. We re-underwrite all of the underlying commercial mortgage loans securing the CMBS. We challenge the estimate of underwriteable cash flow and challenge necessary carve-outs, such as replacement reserves. We study the trends of the industry and geographic location of each property, and independently assess our own estimate of the anticipated cash flow over the period of the loan. Our loan officers physically inspect most of the collateral properties, and assess appraised values based on our own opinion of comparable market values.

Based on the findings of our diligence procedures, we may reject certain mortgage loans from inclusion in the pool. We then formulate our negotiated purchase price and discount to achieve an effective yield on our investment over a ten-year period to approximate 13% to 16%. In computing this estimated yield, we assume a 1% loss rate on the entire underlying mortgage pool.

CMBS transactions are approved by an investment committee and, because of their size, every CMBS transaction is reviewed and approved by the Executive Committee of the Board of Directors. The investment committee for CMBS transactions consists of our most senior commercial real estate professionals and is chaired by our Chairman and Chief Executive Officer.

Portfolio Management

Portfolio Diversity. We monitor the portfolio to maintain both industry and geographic diversity. We currently do not have a policy with respect to concentrating (i.e., investing 25% or more of our total assets) in any industry or group of industries and currently our portfolio is not concentrated. We may or may not concentrate in any industry or group of industries in the future.

Loan Servicing. Our loan servicing staff is responsible for routine loan servicing, which includes:

- delinquency monitoring;
- payment processing;
- borrower inquiries;
- escrow analysis and processing;
- third-party reporting; and
- insurance and tax administration.

In addition, our staff is responsible for special servicing activities including delinquency monitoring and collection, workout administration and management of foreclosed assets.

Portfolio Monitoring and Valuation

We use a grading system in order to help us monitor the credit quality of our portfolio and the potential for capital gains. The grading system assigns grades to investments from 1 to 5, and the portfolio was graded at September 30, 2001 as follows:

Grade	Description	Portfolio at Value	Percentage of Total Portfolio
		(in millions)	
1	Probable capital gain	$ 479.4	22.1%
2	Performing security	1,561.7	71.8%
3	Close monitoring no loss of principal or interest expected	57.3	2.6%
4	Workout Some loss of interest expected	48.0	2.2%
5	Workout Some loss of principal expected	28.0	1.3%
		$2,174.4	100.0%

The 1940 Act requires that the Board of Directors value each asset in the portfolio on a quarterly basis. As a BDC, we are required to value our portfolio of illiquid private or illiquid public securities at fair value. Fair value reflects what you would expect to receive in a current sale, with current sale generally accepted to mean an orderly disposition over a reasonable period of time. We are not permitted to have a general loan loss reserve, but instead must value each specific investment. We have a written valuation policy that governs the valuation of our assets, and we follow a consistent valuation process quarterly. In valuing each individual investment, we consider the financial performance of each portfolio company, loan payment histories, indications of potential equity realization events, and current collateral values, and then determine whether the value of each asset should be increased through unrealized appreciation or decreased through unrealized depreciation. After each investment professional has made his or her determination of value, members of senior management review the valuations. These valuations are then presented to the board of directors for review and approval.

As a general rule, we do not value our loans above principal balance, but loans are subject to depreciation events when the asset is considered impaired. Also as a general rule, equity securities may be assigned appreciation if circumstances warrant. With respect to private equity securities, each investment is valued using industry valuation benchmarks, and then the value is assigned a discount reflecting the illiquid nature of the investments as well as our minority, non-control position. When an external event such as a purchase transaction, public offering, or subsequent equity sale occurs, the pricing indicated by the external event is used to corroborate our private equity valuation. Equity securities in public companies that carry certain restrictions on sale are generally valued at a discount from the public market value of the securities. Restricted and unrestricted publicly traded stocks may also be valued at discounts due to the size of our investment, restrictions on trading or market liquidity concerns.

We monitor loan delinquencies in order to assess the appropriate course of action and overall portfolio quality. With respect to our private finance portfolio, investment professionals closely monitor the status and performance of each individual investment

throughout each quarter. This portfolio company monitoring process includes discussions with the senior management team of the company s financial performance, the review of current financial statements and attendance at portfolio company board meetings. Through the process, investments that may require closer monitoring are generally detected early, and for each such investment, an appropriate course of action is determined. For the private finance portfolio, loan delinquencies or payment default is not necessarily an indication of credit quality or the need to pursue active workout of a portfolio investment. Because we are a provider of long-term privately negotiated investment capital, it is not atypical for us to defer payment of principal or interest from time to time. As a result, the amount of our private finance portfolio that is delinquent at any one time may vary. The terms of our private finance agreements frequently provide an opportunity for our portfolio companies to restructure their debt and equity capital. During such restructuring, we may not receive or accrue interest or dividend payments. Our senior investment professionals actively work with the portfolio company in these instances to negotiate an appropriate course of action.

We price our private finance investment portfolio to provide adequate current returns for our shareholders assuming that a portion of the portfolio at any time may not be accruing interest currently. We also price our investments for a total return including current interest or dividends plus capital gains from sale of equity securities. Therefore, the amount of loans that are delinquent is not necessarily an indication of future principal loss or loss of anticipated investment return. Our 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). We expect 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 our investment. The number of portfolio companies and related investment amount included in Grade 4 and 5 may fluctuate significantly from quarter to quarter as we help these companies work through their problems. We continue to follow our historical practices of working with a troubled portfolio company in order to recover the maximum amount of our investment, but record unrealized depreciation for the expected full amount of the potential loss when such exposure is identified.

With respect to our commercial real estate portfolio, the following outlines the treatment of each delinquency category:

30 Days Past Due	Our loan servicing staff monitors loans and contacts borrowers for collection.
60 Days Past Due	We generally transfer loans to professionals responsible for special servicing activity for monitoring, collection and development of a workout plan, if necessary.
90 Days Past Due	Our accounting department reviews loans in conjunction with the professional responsible for special servicing to determine whether the loans should be placed on a non-accrual status or whether a valuation adjustment is required.
120 Days Past Due	Generally, we place such loans on non-accrual status and the loan is an active workout.

With respect to our Purchased CMBS portfolio, we monitor the performance of the individual loans in the underlying collateral pool through market data and discussions with the pool master servicers and special servicers. The master servicers are responsible for the day-to-day loan servicing functions, including billing, payment processing, collections on loans less than 60 days past due, tax and insurance escrow processing, and annual property inspections. The special servicers are responsible for collections on loans greater than 60 days past due, including workout administration and management of foreclosed properties. We discuss the status of past due or underperforming loans with the master servicers on a monthly basis. When a loan moves to a special servicer, a workout plan is formulated by the special servicer and generally reviewed by us as the directing certificate holder. Once reviewed by us, the special servicer carries out the workout plan, updating us on the status at least monthly. We have the ability to replace the named special servicer at any time.

Since the market for CMBS bonds is relatively illiquid, we do not believe that the fair value of our Purchased CMBS bonds is greater than cost where we intend to hold the investment to maturity, but these CMBS bonds are subject to depreciation events if the fair value is determined to be less than its cost basis. The fair value of these investments considers the current and expected future performance of the underlying loan collateral pool, and the related underlying cash flows that would be generated by the pool as a result of that performance. If we determine that any CMBS bonds will be sold, these bonds will be classified as held for sale and unrealized appreciation or depreciation will be recorded based upon the price at which the CMBS bonds could then be sold.

Investment Gains and Losses

As an investor focused primarily on debt investments, our investment decisions are based on credit dynamics. Our underwriting focuses on the preservation of principal, and we will pursue our available means to recover our capital investment. As a result of this investment discipline and credit culture, we have a history of low levels of loan losses, and have a demonstrated track record of successfully resolving troubled credit situations with minimal losses. Our realized gains from the sale of our equity interests have historically exceeded losses, as is reflected in the chart below.

	Nine Months Ended September 30,		Year Ended December 31,				
	2001	2000	2000	1999	1998	1997	1996
ealized gains	$9,942	$24,664	$28,604	$31,536	$25,757	$15,804	$30,41
ealized losses	(1,603)	$(1,569)	$(13,081)	$(6,145)	$(3,216)	$(5,100)	$(11,262)
et realized gains	8,339	$23,095	$15,523	$25,391	$22,541	$10,704	$19,155
otal assets	2,266,833	$1,731,773	$1,853,817	$1,290,038	$856,079	$807,775	$713,360
ealized losses/ Total assets	.07%	0.09%	0.7%	0.5%	0.4%	0.6%	1.6%

Employees

At September 30, 2001, we employed 95 individuals including investment and portfolio management professionals, operations professionals and administrative staff. The majority of these individuals are located in the Washington, DC office. We believe that our relations with our employees are excellent.

Legal Proceedings

We are a party to certain lawsuits in the normal course of our business. While the outcome of these legal proceedings cannot at this time be predicted with certainty, we do not expect that these proceedings will have a material effect upon our financial condition or results of operations.

PORTFOLIO COMPANIES

The following is a listing of our portfolio companies in which we had an equity investment at September 30, 2001. We make available significant managerial assistance to our portfolio companies. Other than loans to the portfolio company, our only relationship with each portfolio company is our investment. For information relating to the amount and nature of our investments in portfolio companies, see the Consolidated Statement of Investments at September 30, 2001 at pages F-5 to F-12.

Name and Address of Portfolio Company	Nature of its Principal Business	Title of Securities Held by the Company	Percentage of Class Held(1)
Acme Paging, L.P. 1336 Basswood, Suite F Schaumburg, IL 60173	Paging Services	Limited Partnership Interests	1.8%

Allied Office Products, Inc.
Office Products Warrants
to Purchase 2.0%
75 Route 17 South
Common Stock
Hasbrouck Heights, NJ 07604

American Barbecue & Grill,
Inc.
Restaurant Chain Warrants
to Purchase 17.3%
7300 W. 110th Street,
Suite 570
Common Stock
Overland Park, KS 66210

American HomeCare Supply,
LLC
Home Medical Warrants
to 2.1%
One First Avenue
Equipment Purchase Class
A
Suite 100
Provider Common
Units
Conshohocken, PA 19428

Aspen Pet Products, Inc.
Pet Product Series B
Preferred 40.8%
11701 East 53rd Ave.
Provider Stock
Denver, CO 80239
Series A Common
Stock 4.7%
ASW Holding Corporation
Steel Wool
Manufacturer Warrants to
Purchase 5.0%
2825 W. 31st Street
Common Stock

Chicago, IL 60623

Aurora Communications, LLC
Radio Stations Redeemable Preferred 3.2%
3 Stamford Landing, Suite 210
Equity Interest
46 Southfield Avenue

Stamford, CT 06902

Autania AG
Machine and Tool Common Stock 6.2%
Industriestrasse 7
Manufacturer
65779 Kelkheim

Germany

Avborne, Inc.
Aviation Services Warrants to Purchase 3.5%
c/o Trivest, Inc.
Common Stock
2665 S. Bayshore Dr., Suite 800

Miami, FL 33133-5462

Blue Rhino Corporation
Propane Cylinder Exchange Warrants to Purchase 12.9%
104 Cambridge Plaza Drive
Common Stock
Winston-Salem, NC 27104

Border Foods, Inc.
Mexican Ingredient & Series A Convertible 9.4%
J Street
Food Product Preferred Stock
Deming Industrial Park
Manufacturer Warrants to Purchase 6.2%
Deming, NM 88030
Common Stock
Business Loan Express, Inc.
Small Business Lender Preferred Stock 100.0%
645 Madison Ave.
Common Stock 94.9%
19th Floor

New York, NY 10022

Camden Partners Strategic Fund II, L.P. (formerly Cahill-Warnock Strategic Partners Fund II, L.P.) One South Street Suite 2150 Baltimore, MD 21202	Private Equity Fund	Limited Partnership Interest	4.2%
CampGroup, LLC 4 New King Street White Plains, NY 10604	Recreational Camp Operator	Warrants to Purchase Common Stock	2.6%

Name and Address of Portfolio Company	Nature of its Principal Business	Title of Securities Held by the Company	Percentage of Class Held(1)
Candlewood Hotel Company 9342 East Central Wichita, KS 67206	Extended Stay Facilities	Series A Convertible Preferred Stock	5.0%

Celebrities, Inc.
Radio Stations Warrants to
Purchase 25.0%
408-412 W. Oakland Park
Common Stock
Boulevard

Ft. Lauderdale, FL
33311-1712

Colibri Holding Corporation
Outdoor Living
Products Common
Stock 3.4%
2201 S. Walbash Street
Warrants to
Purchase 2.0%
Denver, CO 80231
Common Stock
The Color Factory Inc.
Cosmetic
Manufacturer Preferred
Stock 100.0%
11312 Penrose Street
Common Stock 99.3%
Sun Valley, CA 91352

Component Hardware Group,
Inc.
Designer &
Developer Class A Preferred
Stock 9.1%
1890 Swarthmore Ave.
of Hardware Common
Stock 8.2%
P.O. Box 2020
Components
Lakewood, NJ 08701

Convenience Corporation of
America
Convenience Store
Chain Series A Preferred
Stock 10.0%
711 N. 108th Court
Warrants to
Purchase 4.0%
Omaha, NE 68154
Senior Preferred Stock
Cooper Natural Resources,
Inc.

Sodium Sulfate
Producer Warrants to
Purchase 2.5%
P.O. Box 1477
Common Stock
Seagraves, TX 79360
Series A
Convertible 100% Preferred
Stock Warrants to
Purchase 36.8% Series A
Convertible
Preferred Stock
CorrFlex Graphics, LLC
Packaging
Manufacturer Warrants to
Purchase 4.5%
P.O. Box 1337
Common Stock
Monroe, NC 28110
Options to
Purchase 7.0% Common
Stock
Coverall North America, Inc.
Commercial
Cleaning Warrants to
Purchase 15.0%
500 West Cypress Creek Rd.
Service Common Stock
Ste. 580

Ft. Lauderdale, FL 33309

Csabai Canning Factory Rt.
Food Processing Hungarian
Quotas 9.2%
5600 Békéscasba

Békís: vt 52-54 Hungary

CyberRep
Operator of Call Service
Centers Warrants to
Purchase 24.8%
8300 Greensboro Drive, 6th
Floor
Common Stock
McLean, VA 22102

The Debt Exchange, Inc.
Online Sales of Series B
Convertible 49.0%
101 Arch Street, Suite 410
Distressed Assets Preferred
Stock
Boston, MA 02110

Directory Investment
Corporation
Telephone
Directories Common
Stock 50.0%

1919 Pennsylvania Avenue,
N.W.

Washington, DC 20006

Directory Lending
Corporation
Telephone
Directories Common
Stock 50.0%
1919 Pennsylvania Avenue,
N.W.

Washington, DC 20006

Drilltec Patents &
Technologies Company, Inc.
Drill Pipe
Packager Warrants to
Purchase 15.0%
10875 Kempwood Drive,
Suite 2
Common Stock
Houston, TX 77043

eCentury Capital Partners,
L.P.
Private Equity
Fund Limited
Partnership 25.0%
1101 Connecticut Ave, NW
Interest
7th Floor

Washington, DC 20036

EDM Consulting, LLC
Environmental Common
Stock 25.0%
14 Macopin Avenue
Consulting
Montclair, NJ 07043

Name and Address of Portfolio Company	Nature of its Principal Business	Title of Securities Held by the Company	Percentage of Class Held(1)
Elexis Beta GmbH Ulmenstrabe 22 60325 Frankfurt am Main Germany	Distance Measurement Device Manufacturer	Options to Purchase Shares	9.8%

Esquire Communications Ltd.
Court Reporting Warrants to
Purchase 3.0%
216 E. 45th Street, 8th floor
Services Common Stock
New York, NY 10017

E-Talk Corporation
Telecommunications Warrants to
Purchase 5.5%
4425 Cambridge Road
Software Provider Common
Stock
Fort Worth, TX 76155-2692

Executive Greetings, Inc.
Personalized Business Warrants
to Purchase 1.1%
120 Industrial Park Access Road
Products Common Stock
New Hartford, CT 06057

ExTerra Credit Recovery, Inc.
Consumer Finance Series A
Preferred Stock 0.9%
35 Lennon Lane, Suite 200
Receivable Collections Common
Stock 0.7%
Walnut Creek, CA 94598
Warrants to
Purchase 0.7% Common
Stock
Fairchild Industrial Products
Company
Industrial Controls Warrants to
Purchase 20.0%
3920 Westpoint Boulevard
Manufacturer Common Stock
Winston-Salem, NC 27013

Galaxy American Communications,
Inc.
Cable Television Option to
Purchase 51.0%
1220 N. Main Street
Operator Common LLC
Interest
Sikeston, MO 63801

Garden Ridge Corporation

Home Decor Retailer Series A
Preferred Stock 2.6%
650 Madison Avenue
Common Stock 4.7%
New York, NY 10022

Gibson Guitar Corporation
Guitar Manufacturer Warrants to
Purchase 3.0%
1818 Elm Hill Pike
Common Stock
Nashville, TN 37210

Ginsey Industries, Inc.
Bathroom
Accessories Convertible
Debentures 7.0%
281 Benigno Boulevard
Manufacturer Warrants to
Purchase 16.0%
Bellmawr, NJ 08031
Common Stock
Global Communications I, LLC
Muzak Franchisee Preferred
Equity 59.3%
201 East 69th Street
Interest
New York, NY 10021
Options for
Common 59.3% Membership
Interest
Grant Broadcasting Systems II
Television Stations Warrants to
Purchase 25.0%
919 Middle River Drive,
Common Stock
Suite 409
Warrants to Purchase 25.0%
Ft. Lauderdale, FL 33304
Common Stock in Affiliate
Company
Grant Television, Inc.
Television Stations Equity
Interest 20.0%
(See Grant Broadcasting System II)

Grotech Partners VI, L.P.
Private Equity Fund Limited
Partnership 3.1%
c/o Gntech Capital Group
Interest
9690 Deereco Road

Suite 800

Timonium, MD 21093

The Hartz Mountain Corporation
Pet Supply Common
Stock 2.0%
400 Plaza Drive

Manufacturer Warrants to
Purchase 3.5%
Secaucus, NJ 07094
Common Stock
HealthASPex, Inc.
Third Party Class A
Preferred 26.2%
2812 Trinity Square Drive
Administrator Stock
Carrollton, TX 75006
Common Stock 26.2%
HMT, Inc.
Storage Tank Common
Stock 27.3%
1422 FM 1960 W.
Maintenance & Warrants to
Purchase 10.0%
Suite 350
Repair Common Stock
Houston, TX 77068

Name and Address of Portfolio Company	Nature of its Principal Business	Title of Securities Held by the Company	Percentage of Class Held(1)
Hotelevision, Inc. 599 Lexington Avenue Suite 2300 New York, NY 10022	Hotel Cable-TV Network	Series 3 Preferred Stock	16.2%

Icon International, Inc.
Corporate
Barter Class A
Common Stock 0.8%
281 Tressor Boulevard
Services Class C
Common Stock 0.2%
8th Floor

Stamford, CT 06901

Impact Innovations
Group
Information
Technology Warrants
to Purchase 4.0%
5825 Glenridge Drive
Services
Provider Common
Stock
Building II, Suite 107

Atlanta, GA 30328

International Fiber
Corporation
Cellulose and
Fiber Common
Stock 11.0%
50 Bridge Street
Producer Warrants to
Purchase 2.9%
North Tonawanda, NY
14120
Common Stock
iSolve Incorporated
Corporate Barter
Services Series
A 2.9%
281 Tresser Boulevard
Preferred Stock
Two Stamford Plaza
Common
Stock 1.1%
Stamford, CT 06901

JRI Industries, Inc.
Machinery
Manufacturer Warrants
to Purchase 7.5%
2958 East Division

Common Stock
Springfield, MO 65803

Julius Koch USA, Inc.
Mini-Blind
Cord Warrants to
Purchase 45.0%
387 Church Street
Manufacturer Common
Stock
New Bedford, MA
02745

Kirker Enterprises, Inc.
Nail Enamel Warrants
to Purchase 22.5%
55 East 6th Street
Manufacturer Series B
Common Stock
Paterson, NJ 07524
Equity Interest in
Affiliate
Company 22.5%
Kirkland s, Inc.
Home
Furnishing Series D
Preferred Stock 3.3%
P.O. Box 7222
Retailer Warrants to
Purchase 4.2%
Jackson, TN
38308-7222
Common Stock
Kyrus Corporation
Value-Added
Reseller, Warrants to
Purchase 8.0%
25 Westridge Market
Place
Computer
Systems Common
Stock
Chandler, NC 28715

Liberty-Pittsburgh
Systems, Inc.
Business Forms
Printing Common
Stock 17.2%
265 Executive Drive

Plainview, NY 11803

Logic Bay Corporation
Computer-Based Series
C Redeemable 29.4%
7900 International Drive
Training
Developer Preferred
Stock
Suite 750

Minneapolis, MN 55425

Love Funding
Corporation
Mortgage
Services Series D
Preferred Stock 26.0%
1220 19th Street, NW,
Suite 801

Washington, DC 20036

Magna Card, Inc.
Magnet
Packager Preferred
Stock 6.3%
10315 South Dolifield
Rd.
and
Distributor Common
Stock 5.4%
Owings Mills, MD
21117

Master Plan, Inc.
Healthcare
Outsourcing Common
Stock 13.6%
21540 Plummer Street

Chatsworth, CA 91311

MedAssets.com, Inc.
Healthcare
Outsourcing Series B
Convertible 6.4%
21540 Plummer Street
Preferred Stock
Chatsworth, CA 91311
Warrants to
Purchase 2.9% Preferred
Stock
Mid-Atlantic Venture
Fund IV, L.P.
Private Equity
Fund Limited
Partnership 7.3%
128 Goodman Drive
Interest
Bethlehem, PA 18015

Midview Associates,
L.P.
Residential
Land Warrants to
purchase 35.0%
2 Eaton Street,
Suite 1101
Development partnership
interests
Hampton, VA 23669

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Name and Address of Portfolio Company	Nature of its Principal Business	Title of Securities Held by the Company	Percentage of Class Held(1)
Monitoring Solutions, Inc. 4303 South High School Road Indianapolis, IN 46241	Air Emissions Monitoring	Common Stock Warrants to Purchase Common Stock	25.0% 50.0%

MortgageRamp.com, Inc.
Internet Based Class A
Common 8.0%
116 Welsh Road
Loan Origination Stock
Horsham, PA 19044
Service Platform
Morton Grove
Pharmaceuticals, Inc.
Generic Drug Redeemable
Convertible 27.8%
6451 West Main Street
Manufacturer Preferred
Stock
Morton Grove, IL 60053

MVL Group, Inc.
Market Research Warrants to
Purchase 8.0%
1061 E. Indiantown Road
Services Common Stock
Suite 300

Jupiter, FL 33477

Nobel Learning Communities,
Inc.
Educational
Services Series D
Convertible 100.0%
1400 N. Providence Road,
Preferred Stock
Suite 3055
Warrants to
Purchase 13.1%
Media, PA 19063
Common Stock
North American Archery, LLC
Sporting
Equipment Debentures
Convertible 26.9%
1733 Gunn Highway
Manufacturer into LLC
Equity
Odessa, FL 33556
Interest
Novak Biddle Venture Partners
III, LP
Private Equity Fund Limited
Partnership 2.9%
1750 Tysons Boulevard
Interest

Suite 1190

McLean, VA 22102

Nursefinders, Inc.
Home Healthcare Warrants
to Purchase 3.4%
1200 Copeland Road, Suite 200
Providers Common Stock
Arlington, TX 76011

Onyx Television GmbH
Cable Television Preferred
Units 12.0%
Immedia Park 6b

50670 Koln

Germany

Opinion Research Corporation
Corporate
Marketing Warrants to
Purchase 8.0%
P.O. Box 183
Research Firm Common
Stock
Princeton, NJ 08542

Oriental Trading Company, Inc.
Direct Marketer Redeemable
Preferred 1.7%
108th Street, 4206 South
of Toys Stock
Omaha, NE 68137
Class A Common
Stock 1.7% Warrants to
Purchase 1.4% Common
Stock
Outsource Partners, Inc.
Outsourced Facility Warrants
to Purchase 4.0%
200 Mansell Court East
Services Provider Preferred
Stock
Suite 500
Warrants to
Purchase 4.0%
Roswell, GA 30076
Common Stock
Packaging Advantage
Corporation
Personal Care, Common
Stock 9.9%
4633 Downey Road
Household and Warrants to
Purchase 5.5%
Los Angeles, CA 90058
Disinfectant
Product Common
Stock Packager

Physicians Specialty
Corporation
Physician Practice Common
Stock 80.3%
1150 Lake Hearn Drive
Management Services
Atlanta, GA 30342
Provider
Pico Products, Inc.
Satellite/Television Common
Stock 5.0%
12500 Foothill Boulevard
Component Warrants to
Purchase 15.0%
Lakeview Terr., CA 91342
Manufacturer Common
Stock
Polaris Pool Systems, Inc.
Pool Cleaner Warrants to
Purchase 2.1%
P.O. Box 1149
Manufacturer Common
Stock
San Marcos, CA 92079-1149

Professional Paint, Inc.
Paint Manufacturer Series
A-1 Senior 100.0%
3900 Joliet Street
Exchangeable Preferred
Denver, CO 80239
Stock Common
Stock 11.0%

Name and Address of Portfolio Company	Nature of its Principal Business	Title of Securities Held by the Company	Percentage of Class Held(1)

Progressive International

Corporation
Retail Kitchenware Redeemable
Preferred 12.5%
6111 S. 228th Street
Stock
P.O. Box 97045
Common Stock 0.02%
Kent, WA 98064
Warrants to
Purchase 6.2% Common
Stock
Prosperco Finaz Holding AG
Financial Services Debt
Convertible into 8.5%
Schützengasse 25
Common Stock
CH-8001 Zürich
Common Stock 2.6%
Switzerland
Warrants to
Purchase 5.0% Common
Stock
Raytheon Aerospace, LLC
Aviation Maintenance and Class B
LLC Interest 6.7%
555 Industrial Drive South
Logistics
Madison, MS 39110

Redox Brands, Inc.
Cleaning Products Warrants to
Purchase 3.3%
9100 Centre Point Drive
Common Stock
Suite 200

West Chester, OH 45069

Schwinn Holdings Corporation
Bicycle Manufacturer/ Warrants to
Purchase 0.7%
1690 38th Street
Distributor Common Stock
Boulder, CO 80301

Seasonal Expressions, Inc.
Decorative Ribbon Series A
Preferred Stock 50.0%
230 5th Avenue, Suite 1007
Manufacturer
New York, NY 10001

Soff-Cut Holdings, Inc.
Concrete Sawing Series A Preferred
Stock 4.0%
1112 Olympic Drive
Equipment Manufacturer Common
Stock 2.7%
Corona, CA 91719
Warrants to
Purchase 6.7% Common
Stock
Southern Communications, LLC
Communications Tower Equity
Interest 85.0%
1919 Pennsylvania Ave., NW
Leasing
Washington, DC 20006

Spa Lending Corporation
Health Spas Series A Preferred
Stock 100.0%
1919 Pennsylvania Avenue, N.W.
Series B Preferred Stock 68.4%
Washington, DC 20006
Series C Preferred
Stock 46.3% Common
Stock 62.1%
Staffing Partners Holding
Company, Inc.
Temporary Employee Redeemable
Preferred 48.3%
104 Church Lane #100
Services Stock
Baltimore, MD 21208
Class A-1
Common 50.0% Stock Class
A-2
Common 24.4% Stock Class
B Common 24.0% Stock
Startec Global Communications
Corporation
Integrated Common Stock 1.3%
10411 Motor City Drive
Communications Warrants
to 0.9%
Bethesda, MD 20852
Service Provider Purchase
Common Stock
STS Operating, Inc.
Engineering Design and Common
Stock 42.2%
2301 Windsor Court
Services
Addison, IL 60101

SunSource Inc.
Wholesale Machinery and Common
Stock 93.2%
One Logan Square
Supplies
Philadelphia, PA 19013

Sure-Tel, Inc.

Prepaid Telephone Series A
Convertible 41.7%
5 North McCormick
Services Company Redeemable
Preferred
Oklahoma City, OK 73127
Stock Warrants to
Purchase 9.6% Common
Stock Options to
Purchase 41.7% Common
Stock
Total Foam, Inc.
Packaging Systems Common
Stock 49.0%
P.O. Box 688

Ridgefield, CT 06877

Name and Address of Portfolio Company		Nature of its Principal Business	Title of Securities Held by the Company	Percentage of Class Held(1)
Tubbs Snowshoe Company, LLC	52 River Road Stowe, VT 05672	Snowshoe Manufacturer	Warrants to Purchase Common Units Equity Interests in Affiliate Company	7.7% 10.9%

United Pet Group, Inc.
Manufacturer of Pet Warrants to
Purchase 0.8%
125 High Street
Products Common Stock
Boston, MA 02110

Updata Venture Partners II, L.P.
Private Equity Fund Limited
Partnership 16.1%
11600 Sunrise Valley Drive
Interest
Reston, VA 20191

Velocita, Inc.
Fiber Optic Network Warrants to
Purchase 0.6%
(formerly PF.Net
Common Stock
Communications, Inc.)

677 Washington Blvd.

Stamford, CT 06912

Venturehouse Group, LLC
Private Equity Fund Common Equity
Interest 2.3%
1780 Tysons Blvd., Suite 400

McLean, VA 22102

Walker Investment Fund II, LLLP
Private Equity Fund Limited
Partnership 5.1%
3060 Washington Road
Interest
Suite 200

Glenwood, MD 21738

Warn Industries, Inc.
Sport Utility Accessories Warrants to
Purchase 4.3%
12900 S.E. Capps Rd.
Manufacturer Common Stock
Clackamas, OR 97015

Williams Brothers Lumber

Company

Builders Supplies Warrants to
Purchase 14.1%
3165 Pleasant Hill Road
Common Stock
Duluth, GA 30136

Wilmar Industries, Inc.
Repair and Maintenance Warrants to
Purchase 3.0%
303 Harper Drive
Product Distributor Common Stock
Moorestown, NJ 08057

Wilshire Restaurant Group, Inc.
Restaurant Chain Warrants to
Purchase 3.0%
1100 Town & Country Road
Common Stock
Suite 1300

Orange, CA 92868-4654

Woodstream Corporation
Pest Control Equity Interest in 13.8%
69 North Locust Street
Manufacturer Affiliate Company
Lititz, PA 17543
Warrants to
Purchase 7.2% Common Stock
Wyo-Tech Acquisition Corporation
Vocational School Preferred
Stock 100.0%
4373 N. 3rd Street
Common Stock 99.0%
Laramie, WY 82072

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(1) Percentages shown for warrants and options held represent the percentage of class of security we may own, on a fully diluted basis, assuming we exercise our warrants or options.

DETERMINATION OF NET ASSET VALUE

We determine the net asset value per share of our common stock quarterly. The net asset value per share is equal to the value of our total assets minus liabilities and preferred stock divided by the total number of common shares outstanding.

Portfolio assets are carried at fair value as determined by the board of directors under our valuation policy. As a general rule, we do not value the Company s loans or CMBS bonds above cost, but loans or CMBS bonds are subject to depreciation events when the asset is considered impaired. Also as a general rule, equity securities may be assigned appreciation if circumstances warrant. With respect to private equity securities, each investment is valued using industry valuation benchmarks, and then the value is assigned a discount reflecting the illiquid nature of the investment as well as our minority, non-control position. When an external event such as a purchase transaction, public offering, or subsequent equity sale occurs, the pricing indicated by the external event is used to corroborate our private equity valuation. Equity securities in public companies that carry certain restrictions on sale are generally valued at a discount from the public market value of the securities. Restricted and unrestricted publicly traded stocks may also be valued at discounts, due to the size of our investment or market liquidity concerns.

Determination of fair value involves subjective judgments that cannot be substantiated by auditing procedures. Accordingly, under current standards, the accountants opinion on the Company s financial statements in our annual report refers to the uncertainty with respect to the possible effect on the financial statements of such valuation.

MANAGEMENT

The Board of Directors supervises the management of the Company. The responsibilities of each director include, among other things, the oversight of the loan approval process, the quarterly valuation of our assets, and oversight of our financing arrangements. The board of directors maintains an Executive Committee, Audit Committee, Compensation Committee, and Nominating Committee, and may establish additional committees in the future. Some or all of the Company s directors also serve as directors of its subsidiaries.

Our investment decisions in each business area are made by investment committees composed of the Company s most senior investment professionals. No one person is primarily responsible for making recommendations to a committee.

The Company is internally managed and our investment professionals manage our portfolio and the portfolios of companies for which we serve as investment adviser. These investment professionals have extensive experience in managing investments in private growing businesses in a variety of industries and in diverse geographic locations, and are familiar with our approach of lending and investing. Because the Company is internally managed, we pay no investment advisory fees, but instead we pay the operating costs associated with employing investment management professionals.

Structure of Board of Directors

The Board of Directors is classified into three approximately equal classes with three-year terms, with only one of the three classes expiring each year. Directors serve until their successors are elected and qualified.

Directors

Information regarding the Board of Directors is as follows:

Name	Age	Position	Director Since(1)	Expiration of Term
William L. Walton*	52	Chairman, Chief Executive Officer and President	1986	2004
George C. Williams, Jr.*	75	Chairman Emeritus	1964	2004
Brooks H. Browne	52	Director	1990	2004
John D. Firestone	57	Director	1993	2002
Anthony T. Garcia	45	Director	1991	2002
Lawrence I. Hebert	55	Director	1989	2002
John I. Leahy	71	Director	1994	2003
Robert E. Long	70	Director	1972	2004
Warren K. Montouri	72	Director	1986	2003
Guy T. Steuart II	70	Director	1984	2003
T. Murray Toomey, Esq	77	Director	1959	2003
Laura W. van Roijen	49	Director	1992	2002

* Interested persons of the Company, as defined in the 1940 Act.

(1) Includes service as a director of any of the predecessor companies.

Executive Officers

Information regarding the Company s executive officers is as follows:

Name	Age	Position
William L. Walton	52	Chairman, Chief Executive Officer and President
Joan M. Sweeney	42	Chief Operating Officer
Penni F. Roll	35	Chief Financial Officer
Scott S. Binder	47	Managing Director
Samuel B. Guren	54	Managing Director

Philip A. McNeill	42	Managing Director
John M. Scheurer	49	Managing Director
Thomas H. Westbrook	38	Managing Director
G. Cabell Williams, III	47	Managing Director

Biographical Information

Directors

William L. Walton has been the Chairman, Chief Executive Officer and President of the Company since 1997. He has served on Allied Capital s board of directors since 1986, and was named Chairman and CEO in February 1997. Mr. Walton has an extensive background in general management, marketing, strategic planning, mergers and acquisitions and financial analysis. Mr. Walton previously served as Managing Director of New York-based Butler Capital Corporation, a mezzanine buyout firm, (1987-1991) and was the personal venture capital advisor for William S. Paley, founder and Chairman of CBS. In addition, he was a Senior Vice President in Lehman Brother Kuhn Loeb s Investment Banking Group. Mr. Walton also founded and managed two start-up businesses, Success Lab, Inc. and Language Odyssey, in the emerging education industry

(1992-1996). Mr. Walton is a director of Nobel Learning Communities, Inc., Riggs National Corporation and the National Venture Capital Association. He received both a B.A. and a M.B.A. from Indiana University.

George C. Williams, Jr. is Chairman Emeritus of the Company. Mr. Williams was an officer of the predecessor companies from the later of 1959 or the inception of the relevant entity and President or Chairman and Chief Executive Officer of the predecessor companies from the later of 1964 or each entity s inception until 1991. Mr. Williams is the father of G. Cabell Williams III, an executive officer of the Company.

Brooks H. Browne has been the President of Environmental Enterprises Assistance Fund since 1993. Mr. Browne is a director of SEAF, Corporation Financiera Ambiental (Panama), Empresas Ambientales de Centro America (Costa Rica) Renewable Energy and Energy Efficiency Fund, Terra Capital Investors Limited, the Solar Development Foundation, and Yayasan Bina Usaha Lingkungan (Indonesia) (environmental nonprofit or investment funds).

John D. Firestone has been a Partner of Secor Group (venture capital) since 1978. Mr. Firestone is a director of Security Storage Company of Washington, DC, Bryn Mawr Bank Corporation and the National Organization on Disability. Mr. Firestone is Senior Advisor to GeoPortals.com, and a Trustee of The Washington Ballet.

Anthony T. Garcia is currently a private investor. Mr. Garcia was General Manager of Breen Capital Group (investor in tax liens) from 1997 to 2000 and a Senior Vice President of Lehman Brothers Inc. from 1985 to 1996.

Lawrence I. Hebert is a director and President and Chief Executive Officer of Riggs Bank N.A. (a subsidiary of Riggs National Corporation) since February 2001; Director of Riggs National Corporation since 1988. He also serves as director of Riggs Investment Management Corporation and Riggs Bank Europe Limited (both indirect subsidiaries of Riggs National Corporation). Mr. Hebert is the President and a director Perpetual Corporation (owner of Allbritton Communications Company and ALLSNEWSCO, Inc.) Mr. Hebert is a director of ALLSNEWSCO, Inc. (news programming service), the President of Westfield News Advertiser, Inc. (owner of a television station and newspapers), Trustee of The Allbritton Foundation and Vice Chairman of Allbritton Communications Company. Mr. Hebert previously served as Vice Chairman (1983 to 1998), President (1984 to 1998) and Chairman and Chief Executive Officer (1998 to 2001) of Allbritton Communications Company.

John I. Leahy has been the President of Management and Marketing Associates (a management consulting firm) since 1986. Mr. Leahy was the President and Group Executive Officer, Western Hemisphere of Black & Decker Corporation from 1982 to 1985. Mr. Leahy is a director of Kar Kraft Systems, Inc., Cavanaugh Capital, Inc., Acorn Products, Inc., The Wills Group, Thulman-Eastern Company and Gallagher Fluid Seals, Inc.

Robert E. Long is the CEO and Director of Goodwyn, Long & Black Investment Management, Inc. and has been the Chairman and Chief Executive Officer of Emerald City Radio Partners, LLC since 1997. Mr. Long was the President of Business News Network, Inc. from 1995 to 1998, was the Chairman and Chief Executive Officer of Southern Starr Broadcasting Group, Inc. from 1991 to 1995, and a director and the President of Potomac Asset Management, Inc. from 1983 to 1991. Mr. Long is a director of AmBase Corporation, CSC Scientific, Inc., and Advanced Solutions International, Inc.

Warren K. Montouri has been a Partner of Montouri & Roberson (real estate investment firm) since 1980. Mr. Montouri was a director of C&S/Sovran Bank from 1970 to 1990, a director of Sovran Financial Corporation from 1989 to 1990, a director of NationsBank, N.A. from 1990 to 1996, a director of BB&T Bank (formerly Franklin National Bank) from 1996 to 2000, a Trustee of Suburban Hospital from 1991 to 1994, and a Trustee of The Audubon Naturalist Society from 1979 to 1985.

Guy T. Steuart II has been a director and President of Steuart Investment Company (manages, operates, and leases real and personal property and holds stock in operating subsidiaries engaged in various businesses) since 1960. Mr. Steuart is Trustee Emeritus of Washington and Lee University.

T. Murray Toomey, Esq. has been an attorney at law since 1949. Mr. Toomey is a director of The National Capital Bank of Washington and Federal Center Plaza Corporation. He is also a Trustee of The Catholic University of America.

Laura W. van Roijen has been a private real estate investor since 1992. Ms. van Roijen was the Chairman of CWV & Associates (RTC qualified contracting firm) from 1991 to 1994, a director and the Treasurer of Black Possum Inc. (retail concern) from 1994 to 1996, the President of Volta Place, Inc. (real estate advisory firm) from 1991 to 1994, and Vice President (from 1986 to 1991) and Market Director (from 1989 to 1991) of Citicorp Real Estate, Inc.

Executive Officers who are not Directors

Joan M. Sweeney, Chief Operating Officer, has been employed by the Company since 1993. Ms. Sweeney oversees all company operations and is responsible for strategic planning, financial management, information technology, marketing, investor relations, and all regulatory compliance. Prior to joining the Company, Ms. Sweeney spent ten years of her career consulting with private and small public companies at both Ernst & Young and Coopers & Lybrand. Ms. Sweeney was a member of the SEC Division of Enforcement in the late 1980s.

Penni F. Roll, Chief Financial Officer, has been employed by the Company since 1995. Ms. Roll is responsible for the Company s financial management and reporting, accounting, loan servicing, special servicing, portfolio monitoring and regulatory compliance activities. Prior to joining the Company, she spent seven years in the financial services practice at KPMG Peat Marwick, including serving as a Manager from 1993 to 1995.

Scott S. Binder, Managing Director, has worked with the Company since 1991 and is responsible for the Company s managed fund investment activities. Prior to joining the Company, Mr. Binder formed and was President of Overland Communications Group, which owned and operated cable television systems and radio stations. He also has worked in the specialty finance and leasing industry.

Samuel B. Guren, Managing Director, joined the Company in 1999. He joined the Company to develop the Company s private equity investment business. Mr. Guren has more than 26 years of venture capital investing experience. Prior to joining the Company, Mr. Guren was the Senior Managing Partner at Baird Capital. He also served as a Senior Managing Partner at William Blair Venture Partners for 15 years.

Philip A. McNeill, Managing Director, has been employed by the Company since 1993 and is responsible for co-managing the Company s private finance group. Before joining the Company, he served as a vice president of M&T Capital Corporation. Prior to entering the private finance industry, he was founding director of Western Oklahoma National Bank, and structured and managed numerous privately negotiated investments.

John M. Scheurer, Managing Director, has been employed by the Company since 1991 and manages the Company s commercial real estate finance group. He has more than 22 years of experience in commercial finance and real estate lending and management. Prior to joining the Company, Mr. Scheurer worked in various capacities with Capital Recovery Advisors, Inc. and First American Bank. He also started his own company, The Scheurer Company, and co-founded Hunter & Associates, a major leasing and consulting real estate firm in the Washington, DC area.

Thomas H. Westbrook, Managing Director, has been with the Company since 1991 and is responsible for co-managing the Company s private finance group. Prior to joining the Company, Mr. Westbrook worked with North Carolina Enterprise Fund and was a lending officer in NationsBank s corporate lending unit. He is the former president of the southern RASBIC and has served on the NASBIC Board of Governors.

G. Cabell Williams, III, Managing Director, has been employed by the Company since 1981 in the Company s private finance group. He has over 19 years of private finance experience, and has structured numerous types of private debt and equity finance transactions. Mr. Williams has served in many capacities during his tenure with the Company.

Employment Agreements

The Company has entered into employment agreements with eight senior executives of the Company, including William L. Walton, the Company s Chairman and CEO, Joan M. Sweeney, Chief Operating Officer, and John M. Scheurer, Managing Director. Each of the agreements provides for a three-year term, with annual renewals thereafter, and specifies each executive s compensation during the term of the agreement, in accordance with the achievement of certain performance standards.

The annual base salary on the effective date of the employment agreements of Mr. Walton, Ms. Sweeney, and Mr. Scheurer was $405,000, $256,500, and $256,500, respectively. The Board of Directors has the right to increase the base salary during the term of the employment agreement. In addition, each employment agreement states that the Board of Directors may provide, at their sole discretion, an annual cash bonus. This bonus is to be determined with reference to each executive s performance in accordance with performance criteria to be determined by the Board in its sole discretion. Under each agreement, each executive also is entitled to participate in the Company s Amended Stock Option Plan, and to receive all other awards and benefits previously granted to each executive including life insurance premiums.

In addition, each employment agreement provides for a long-term cash retention award for the performance period from 2001 through 2003. The long-term cash retention award will vest and be payable in six equal installments on June 30th and December 31st of each year from 2001 through 2003. Mr. Walton will be eligible for a long-term cash retention award of $3,375,000, or $1,125,000 per year, over the performance period; Ms. Sweeney will be eligible for $2,550,000, or $850,000 per year; and Mr. Scheurer will be eligible for $2,115,000, or $705,000 per year.

Employment will terminate if the term of the agreement expires without written agreement of both parties. The executive has the right to voluntarily terminate employment at any time with 30 days notice, and in such case, the employee will not receive any severance pay. Among other things, the employment agreements prohibit the solicitation of employees from the Company in the event of an executive s departure for a period of two years.

If employment is terminated with cause, the employee will not receive any severance pay. If employment is terminated without cause during the term of the agreement, the executive shall be entitled to severance pay for a period not to exceed 36 months for Mr. Walton; 30 months for Ms. Sweeney; and 24 months for Mr. Scheurer. Severance pay shall include the continuation of the employee s base salary, and the greater of (a) the average of the annual bonuses paid during the preceding three years, or (b) the amount of the last annual bonus paid to the employee. In addition, the executive shall be entitled to receive any payments under the long-term cash retention award that would have vested and been payable during the severance period. However, stock options would cease to vest during the severance period.

If, within 12 months after a change of control (as defined in the employment agreements) termination of employment occurs either by the executive officer or the Company, the executive officer shall not be entitled to severance pay, but will instead be entitled to lump sum compensation as well as certain other benefits. For Mr. Walton, this lump sum is equal to three years of base salary and bonus (as calculated for severance pay), plus an amount equal to $5,565,000. For Ms. Sweeney, this lump sum is equal to two and a half years of base salary and bonus, plus an amount equal to $2,600,000. For Mr. Scheurer, this lump sum is equal to two years of base salary and bonus, plus an amount equal to $2,350,000. Under the terms of the agreement, the Company would also provide compensation to offset any applicable excise tax penalties imposed on the executive under section 4999 of the Internal Revenue Code.

The other six employment agreements carry terms substantially similar to those of Mr. Scheurer s agreement, as described herein.

Compensation Plans

Stock Option Plan

The Company s stock option plan (the Stock Option Plan) is intended to encourage stock ownership in the Company by officers and directors, thus giving them a proprietary interest in the Company s performance. The Stock Option Plan was approved by shareholders at the Special Meeting of Shareholders on November 26, 1997. On May 9, 2000, the Company s stockholders amended the Stock Option Plan to increase the authorized shares under the plan to 12,350,000 shares as well as make certain other administrative changes.

The Committee s principal objective in awarding stock options to the eligible officers of the Company is to align each optionee s interests with the success of the Company and the financial interests of its stockholders by linking a portion of such optionee s compensation with the performance of the Company s stock and the value delivered to stockholders.

Stock options are granted under the Stock Option Plan at a price not less than the prevailing market value and will have value only if the Company s stock price increases.

The Committee determines the amount and features of the stock options, if any, to be awarded to optionees. The Committee evaluates a number of criteria, including the past service of each such optionee to the Company, the present and potential contributions of such optionee to the success of the Company and such other factors as the Committee shall deem relevant in connection with accomplishing the purposes of the Stock Option Plan, including the recipient s current stock holdings, years of service, position with the Company and other factors. The Committee does not apply a formula assigning specific weights to any of these factors when making its determination. The Committee awards stock options on a subjective basis and such awards depend in each case on the performance of the officer under consideration.

For the nine months ended September 30, 2001 and for the year ended, December 31, 2000, a total of 2,800,323 and 4,162,112 options, respectively, were granted, including grants made by the Company s compensation committee to certain officers and automatic grants to non-officer directors of the Company. These options generally vest over a three-year period except that grants to non-officer directors vest immediately. See Control Persons and Principal Holders of Securities in the SAI for currently exercisable options granted to certain executive officers and non-officer directors.

On September 8, 1999, the Company received approval from the Commission to grant options under the Stock Option Plan to non-officer directors. On that date, each incumbent non-officer director received options to purchase 10,000 shares, and pursuant to the Commission order, each will receive options to purchase 5,000 shares each year thereafter on the date of the annual meeting of stockholders. New directors will receive options to purchase 10,000 shares upon election to the board, and options to purchase 5,000 shares each year thereafter on the date of the annual meeting.

The Stock Option Plan is designed to satisfy the conditions of Section 422 of the Code so that options granted under the Stock Option Plan may qualify as incentive stock options. To qualify as incentive stock options, options may not become exercisable for the first time in any year if the number of incentive options first exercisable in that year multiplied by the exercise price exceeds $100,000.

Formula Award and Cut-Off Award

Formula Award. The Formula Award was designed as an incentive compensation program that would replace stock options of the predecessor companies that were cancelled as a result of the Company s 1997 merger, and would balance share ownership among key officers. The Company accrued the Formula Award over the three-year period on the anniversary of the merger date (December 31) in 1998, 1999 and 2000. The Formula Award expense for 1998, 1999 and 2000 totaled $6.2 million, $6.2 million and $5.7 million, respectively, and is included in employee expenses in the Company s consolidated statement of operations. The terms of the Formula Award required that the award be contributed to the Company s deferred compensation plan, and used to purchase shares of the Company in the open market. See Deferred Compensation Plan. The amount of the Formula Awards received by certain executive officers in 2000 is provided in the SAI.

On January 2, 2001, the trust that holds the deferred compensation plan distributed shares of the Company s common stock with a value of $4,383,165 representing the final portion of the Formula Award that vested on December 31, 2000. These shares are held in restricted accounts at a brokerage firm.

Cut-Off Award. 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 on December 31, 1997. The Cut-Off Award is payable for each canceled option as the canceled options would have vested and vests automatically in the event of a change of control. The Cut-Off Award is payable if the award recipient is employed by the Company on the future vesting date. The Cut-Off Award expense for the nine months ended September 30, 2001 and for the year ended December 31, 2000 totaled $0.09 million and $0.5 million respectively, and is included in employee expenses in the Company s consolidated statement of operations. The amount of the Cut-Off Award received by certain executive officers in 2000 is provided in the SAI.

401(k) Plan

The Company maintains a 401(k) plan (the 401(k) Plan). All employees who are at least 21 years of age have the opportunity to contribute pre-tax salary deferrals into the 401(k) Plan of up to $10,500, and to direct the investment of these contributions. The 401(k) Plan allows eligible participants to invest in shares of the Company s common stock, among other investment options. In addition, beginning in 2000, the Company contributed to each eligible participant s (i.e., employees with 1,000 hours of service) 401(k) account 5% of each participant s cash compensation as defined by the 401(k) Plan. Employer contributions that exceed $8,500 (5% of $170,000 cash compensation) are directed to the participant s Deferred Compensation Plan account. All contributions are fully vested at the time of contribution. On September 30, 2001, the 401(k) Plan held less than 1% of the outstanding shares of the Company.

Deferred Compensation Plan

The Company maintains a deferred compensation plan. The deferred compensation plan is a funded plan that provides for the deferral of compensation by employees and consultants of the Company. Employees and consultants of the Company are eligible to participate in the plan at such time and for such period as designated by the board of directors. The deferred compensation plan is administered through a trust, and the Company funds this plan through cash contributions.

TAX STATUS

The following discussion is a general summary of the material United States federal income tax considerations applicable to the Company and to an investment in the common stock. This summary does not purport to be a complete description of the income tax considerations applicable to such an investment. The discussion is based upon the Code, Treasury Regulations, and administrative and judicial interpretations, each as of the date of this prospectus and all of which are subject to change. You should consult your own tax advisor with respect to tax considerations that pertain to your purchase of the common stock.

This summary is intended to apply to investments in common stock and assumes that investors hold the common stock as capital assets. This summary does not discuss all aspects of federal income taxation relevant to holders of the common stock in light of particular circumstances, or to certain types of holders subject to special treatment under federal income tax laws, including dealers in securities, pension plans and trusts and *financial institutions. This summary does not discuss any aspects of U.S. estate and gift tax or foreign, state or local tax. It does not discuss the special treatment under federal income tax laws that could result if the Company invested in tax-exempt securities or certain other investment assets.*

This summary does not discuss the consequences of investments in preferred stock or debt securities of the Company. The tax consequences of an offering of preferred stock or debt securities of the Company will be discussed in a prospectus supplement relating to or for such offering.

Except as specifically indicated herein, this summary is intended to apply to U.S. Stockholders (as defined below) and does not purport to discuss all U.S. federal income tax consequences to persons who are not U.S. Stockholders (Non-U.S. Stockholders) from an investment in the common stock. (A U.S. Stockholder is a stockholder who is (i) a citizen or resident of the United States, (ii) a corporation, partnership or other entity created in or organized under the laws of the United States or any political subdivision thereof, (iii) an estate, the income of which is subject to United States federal income taxation regardless of its source, or (iv) a trust subject to the supervision of a court within the United States and the control of a United States person.) Non-U.S. Stockholders should consult their own tax advisors to discuss the consequences of an investment in the common stock.

Taxation as a RIC

The Company intends to be treated for tax purposes as a regulated investment company or RIC under Subchapter M of the Code. If the Company (i) qualifies as a RIC and (ii) distributes to stockholders in a timely manner at least 90% of its investment company taxable income, as defined in the Code (i.e., net investment income, including accrued original issue discount, and net short-term capital gain) (the 90% Distribution Requirement) each year, it will not be subject to federal income tax on the portion of its investment company taxable income and net capital gain (i.e., net long-term capital gain in excess of net short-term capital loss) it distributes (or treats as deemed distributed) to stockholders. In addition, if the Company distributes in a timely manner the sum of (i) 98% of its ordinary income for each calendar year, (ii) 98% of its capital gain net income for the one-year period ending December 31 in that calendar year, and (iii) any income not distributed in prior years, the Company will not be subject to the 4% nondeductible federal excise tax on certain undistributed income of RICs (the Excise Tax Avoidance Requirements). The Company generally will endeavor to distribute (or treat as deemed distributed) to stockholders all of its investment company taxable income and its net capital gain, if any, for each taxable year so that it will not incur federal income or excise taxes on its earnings. The Company will be subject to federal income tax at the regular corporate rate for any amounts of investment company taxable income or net capital gain not distributed (or deemed distributed) to the stockholders.

In order to qualify as a RIC for federal income tax purposes, the Company must, among other things: (a) continue to qualify as a BDC under the 1940 Act, (b) derive in each taxable year at least 90% of its gross income from dividends, interest, payments with respect to securities loans, gains from the sale of stock or other securities, or other income derived with respect to its business of investing in such stock or securities (the 90% Income Test); and (c) diversify its holdings so that at the end of each quarter of the taxable year (i) at least 50% of the value of the Company s assets consists of cash, cash items, U.S. government securities, securities of other RICs, and other securities if such other securities of any one issuer do not represent more than 5% of the Company s assets or more than 10% of the outstanding voting securities of the issuer, and (ii) no more than 25% of the value of the Company s assets is invested in the securities (other than U.S. government securities or securities of other RICs) of any one issuer or of two or more issuers that are controlled (as determined under applicable Code rules) by the Company and are engaged in the same or similar or related trades or businesses (the Diversification Tests). The failure of one or more of the Company s subsidiaries to continue to qualify as RICs could adversely affect the Company s ability to satisfy the Diversification Tests.

If the Company acquires or is deemed to have acquired debt obligations that were issued originally at a discount or that otherwise are treated under applicable tax rules as having original issue discount, it must include in income each year a portion of the original issue discount that accrues over the life of the obligation regardless of whether cash representing such income is received by it in the same taxable year. Any amount accrued as original issue discount will be included in the Company s investment company taxable income for the year of accrual and may have to be distributed to the stockholders in order to satisfy the 90% Distribution Requirement or the Excise Tax Avoidance Requirements even though the Company has not received any cash representing such income.

Although it does not currently intend to do so, if the Company were to invest in certain options, futures, or forward contracts, it may be required to report income from such investments on a mark-to-market basis, which could result in the Company recognizing unrealized gains and losses for federal income tax purposes even though it may not realize such gains and losses when it ultimately disposes of such investments. The Company could also be required to treat such gains and losses as 60% long-term capital gain or loss and 40% short-term capital gain or loss regardless of its holding period for the investments. In addition, if the Company were to engage in certain hedging transactions, including hedging transactions in options, future contracts, and straddles, or other similar transactions, it will be subject to special tax rules (including constructive sale, mark-to-market, straddle, wash sale, and short sale rules), the effect of which may be to accelerate income to the Company, defer losses to the Company, cause adjustments in the holding periods of the Company s securities, convert long-term capital gains into short-term capital gains or convert short-term capital losses into long-term capital losses. These rules could affect the Company s investment company taxable income or net capital gain for a taxable year and thus affect the amounts that the Company would be required to distribute to its stockholders pursuant to the 90% Distribution Requirement and the Excise Tax Avoidance Requirements for such year.

Although it does not presently expect to do so, the Company is authorized to borrow funds and to sell assets in order to satisfy distribution requirements. However, under the 1940 Act, the Company is not permitted to make distributions to stockholders while the Company s debt obligations and other senior securities are outstanding unless certain asset coverage tests are met. Moreover, the Company s ability to dispose of assets to meet its distribution requirements may be limited by other requirements relating to its status as a RIC, including the Diversification Test. If the Company disposes of assets in order to meet the 90% Distribution Requirement or the Excise Tax Avoidance Requirements, the Company may make such dispositions at times that, from an investment standpoint, are not advantageous.

If the Company fails to satisfy the 90% Distribution Requirement or otherwise fails to qualify as a RIC in any taxable year, it will be subject to tax in that year on all of its taxable income, regardless of whether it makes any distributions to its stockholders. In that case, all of the Company s distributions to its stockholders will be characterized as ordinary income (to the extent of the Company s current and accumulated earnings and profits). In contrast, as is explained below, if the Company qualifies as a RIC, a portion of its distributions or deemed distributions may be characterized as long-term capital gain in the hands of stockholders.

The remainder of this Summary assumes that the Company qualifies as a RIC and satisfies the 90% Distribution Requirement.

Taxation of Stockholders

Distributions of the Company generally are taxable to stockholders as ordinary income or capital gains. Distributions of the Company s investment company taxable income will be taxable as ordinary income to stockholders to the extent of the Company s current or accumulated earnings and profits, whether paid in cash or reinvested in additional common stock. Distributions of the Company s net capital gains properly designated by the Company as capital gain dividends will be taxable to a stockholder as long-term capital gains regardless of the stockholder s holding period for his or her common stock and regardless of whether paid in cash or reinvested in additional common stock (including any dividends reinvested through the company s DRIP plan). Distributions in excess of the Company s earnings and profits first will reduce a stockholder s adjusted tax basis in such stockholder s common stock and, after the adjusted basis is reduced to zero, will constitute capital gains to such stockholder.

At the Company s option, the Company may elect to retain some or all of its net capital gains for a tax year, but designate the retained amount as a deemed distribution. In that case, among other consequences, the Company will pay tax on the retained amount for the benefit of its stockholders, the stockholders will be required to report their share of the deemed distribution on their tax returns as if it had been distributed to them, and the stockholders will report a credit for the tax paid thereon by the Company. The amount of the deemed distribution net of such tax will be added to the stockholder s cost basis for his or her common stock. Since the Company expects to pay tax on any retained net capital gains at its regular corporate capital gain tax rate, and since that rate is in excess of the maximum rate currently payable by individuals on long-term capital gains, the amount of tax that individual stockholders will be treated as having paid and for which they will receive a credit will exceed the amount of tax that such stockholders would be required to pay on the retained net capital gains. Such excess generally will be available to offset other tax liabilities of the stockholders. A stockholder that is not subject to U.S. federal income tax should be able to file a return on the appropriate form or a claim for refund that allows such stockholder to recover the taxes paid on his or her behalf. In the event the Company chooses this option, it must provide written notice to the stockholders prior to the expiration of 60 days after the close of the relevant tax year.

Any dividend declared by the Company in October, November, or December of any calendar year, payable to stockholders of record on a specified date in such a month and actually paid during January of the following year, will be treated as if it had been received by the stockholders on December 31 of the year in which the dividend was declared.

You should consider the tax implications of buying common stock just prior to a distribution. Even if the price of the common stock includes the amount of the forthcoming distribution, you may be taxed upon receipt of the distribution and will not be entitled to offset the distribution against the tax basis in your common stock.

You may recognize taxable gain or loss if you sell or exchange your common stock. The amount of the gain or loss will be measured by the difference between your adjusted tax basis in your common stock and the amount of the proceeds you receive in exchange for such stock. Any gain or loss arising from (or, in the case of distributions in excess of earnings and profits, treated as arising from) the sale or exchange of common stock generally will be a capital gain or loss. This capital gain or loss normally will be treated as a long-term capital gain or loss if you have held your common stock for more than one year; otherwise, it will be classified as short-term capital gain or loss. However, any capital loss arising from the sale or exchange of common stock held for six months or less generally will be treated as a long-term capital loss to the extent of the amount of capital gain dividends received (or treated as deemed distributed) with respect to such stock and, for this purpose, the special rules of Section 852(b)(4)(C) of the Code generally apply in determining the holding period of such stock. In addition, all or a portion of any loss realized upon a taxable disposition of common stock may be disallowed if other shares of the Company s common stock are purchased (under the Company s DRIP or otherwise) within 30 days before or after the disposition.

In general, non-corporate stockholders currently are subject to a maximum federal income tax rate on their net long-term capital gain (the excess of net long-term capital gain over net short-term capital loss) for a taxable year (including a long-term capital gain derived from an investment in the common stock of the company) that is lower than the maximum rate for other income. Corporate taxpayers currently are subject to federal income tax on net capital gains at a maximum rate equal to the maximum rate applied to ordinary income. Tax rates imposed by states and local jurisdictions on capital gain and ordinary income may differ. Non-corporate stockholders with net capital losses for a year (i.e., capital losses in excess of capital gains) generally may deduct up to $3,000 of such losses against their ordinary income each year; any net capital losses of a non-corporate stockholder in excess of $3,000 generally may be carried forward and used in subsequent years as provided in Section 1212(b) of the Code. Corporate stockholders generally may not deduct any net capital losses for a year, but may carryback such losses for three years or carry forward such losses for five years.

The Company will send to each of its stockholders, as promptly as possible after the end of each calendar year, a notice detailing, on a per share and per distribution basis, the amounts includible in such stockholder s taxable income for such year as ordinary income and as long-term capital gain. In addition, the federal tax status of each year s distributions generally will be reported to the IRS. Distributions may also be subject to additional state, local, and foreign taxes depending on a stockholder s particular situation. The Company s ordinary income dividends to corporate stockholders may, if certain conditions are met, qualify for the dividends received deduction to the extent that the Company has received qualifying dividend income during the taxable year; capital gain dividends distributed by the Company are not eligible for the dividends received deduction.

A Non-U.S. Stockholder may be subject to withholding of U.S. federal tax at a 30% rate (or lower applicable treaty rate) on distributions (including certain redemptions of common stock) from the Company. Accordingly, investment in the Company is likely to be appropriate for a Non-U.S. Stockholder only if such person can utilize a foreign tax credit or corresponding tax benefit in respect of such withholding tax. Non-U.S. Stockholders should consult their own tax advisors with respect to the U.S. federal income and withholding tax, and state, local, and foreign tax, consequences of an investment in the common stock.

The Company may be required to withhold U.S. federal income tax (backup withholding) from all taxable distributions payable to (i) any stockholder who fails to furnish the Company with its correct taxpayer identification number or a certificate that the stockholder is exempt from backup withholding, and (ii) any stockholder with respect to whom the IRS notifies the Company that the stockholder has failed to properly report certain interest and dividend income to the IRS and to respond to notices to that effect. The Company may be required to report annually to the IRS and to each Non-U.S. Stockholder the amount of dividends paid to such stockholder and the amount, if any, of tax withheld pursuant to the backup withholding rules with respect to such dividends. This information may also be made available to the tax authorities in the Non-U.S. Stockholder s country of residence. Backup withholding is not an additional tax. Any amounts withheld under the backup withholding rules from payments made to a stockholder may be refunded or credited against such stockholder s United States federal income tax liability, if any, provided that the required information is furnished to the IRS.

You should consult your own tax advisor with respect to the particular tax consequences to you of an investment in the Company, including the possible effect of any pending legislation or proposed regulation.

CERTAIN GOVERNMENT REGULATIONS

We operate in a highly regulated environment. The following discussion generally summarizes certain regulations.

Business Development Company (BDC). A business development company is defined and regulated by the Investment Company Act of 1940. It is a unique kind of investment company that primarily focuses on investing in or lending to small private companies and making managerial assistance available to them. A BDC may use capital provided by public shareholders and from other sources to invest in long-term, private investments in growing businesses. A BDC provides shareholders the ability to retain the liquidity of a publicly traded stock, while sharing in the possible benefits, if any, of investing in privately owned growth companies.

As a BDC, we may not acquire any asset other than Qualifying Assets unless, at the time we make the acquisition, our Qualifying Assets represent at least 70% of the value of our total assets (the 70% test). The principal categories of Qualifying Assets relevant to our business are:

(1) Securities purchased in transactions not involving any public offering, the issuer of which is an eligible portfolio company. An eligible portfolio company is defined to include any issuer that (a) is organized and has its principal place of business in the United States, (b) is not an investment company other than an SBIC wholly owned by a BDC (our investment in Allied Investment and certain other subsidiaries generally are Qualifying Assets), and (c) does not have any class of publicly traded securities with respect to which a broker may extend margin credit;

(2) Securities received in exchange for or distributed with respect to securities described in (1) above or pursuant to the exercise of options, warrants, or rights relating to such securities; and

(3) Cash, cash items, government securities, or high quality debt securities (within the meaning of the 1940 Act), maturing in one year or less from the time of investment.

To include certain securities described above as Qualifying Assets for the purpose of the 70% test, a BDC must make available to the issuer of those securities significant managerial assistance such as providing significant guidance and counsel concerning the management, operations, or business objectives and policies of a portfolio company, or making loans to a portfolio company. We will provide managerial assistance on a continuing basis to any portfolio company that requests it, whether or not difficulties are perceived.

As a BDC, the Company is entitled to issue senior securities in the form of stock or senior securities representing indebtedness, including debt securities and preferred stock, as long as each class of senior security has an asset coverage of at least 200% immediately after each such issuance. This limitation is not applicable to borrowings by our SBIC subsidiary, and therefore any borrowings by these subsidiaries are not included in this asset coverage test. See Risk Factors.

We have adopted a Code of Ethics that establishes procedures for personal investments and restricts certain transactions by the Company s personnel. A copy of the Code of Ethics may be reviewed at or obtained from the Commission. See Where You Can Find More Information.

We may not change the nature of our business so as to cease to be, or withdraw our election as, a BDC unless authorized by vote of a majority of the outstanding voting securities, as defined in the 1940 Act, of our shares. Since we made our BDC election, we have not made any substantial change in the nature of our business.

Regulated Investment Company (RIC). Our status as a RIC enables us to avoid the cost of federal taxation and generally avoid the cost of state taxation, and as a result achieve pre-tax investment returns. We believe that this tax advantage enables us to achieve strong equity returns without having to aggressively leverage our balance sheet.

In order to qualify as a RIC, the Company must, among other things:

(1) Continue to qualify as a BDC.

(2) Derive at least 90% of its gross income from dividends, interest, payments with respect to securities loans, gains from the sale of stock or other securities or other income derived with respect to its business of investing in such stock or securities.

(3) Diversify its holdings so that

(a) at least 50% of the value of the Company s assets consists of cash, cash items, U.S. government securities, securities of other RICs and other securities if such other securities of any one issuer do not represent more than 5% of the Company s assets and 10% of the outstanding voting securities of the issuer, and

(b) no more than 25% of the value of the Company s assets are invested in securities (other than U.S. government securities) of any one issuer, or of two or more issuers that are controlled by the Company and which are engaged in same or similar or related trades or businesses.

(4) Distribute at least 90% of its investment company taxable income each tax year to its shareholders. In addition, if the Company distributes in a timely

manner (or treats as deemed distributed) 98% of its capital gain net income for each one year period ending on December 31 and distributes 98% of its ordinary income for each calendar year, it will not be subject to the 4% nondeductible federal excise tax on certain undistributed income of RICs.

SBA Regulations. Allied Investment, a wholly owned subsidiary of the Company, is licensed by the SBA as an SBIC under Section 301(c) of the Small Business Investment Act of 1958, as amended (the 1958 Act), and has elected to be regulated as a BDC.

SBICs are authorized to stimulate the flow of private equity capital to eligible small businesses. Under present SBA regulations, eligible small businesses include businesses that have a net worth not exceeding $18 million and have average annual fully taxed net income not exceeding $6 million for the most recent two fiscal years. In addition, an SBIC must devote 20% of its investment activity to smaller concerns as defined by the SBA. A smaller concern is one that has a net worth not exceeding $6 million and has average annual fully taxed net income not exceeding $2 million for the most recent two fiscal years. SBA regulations also provide alternative size standard criteria to determine eligibility, which depend on the industry in which the business is engaged and are based on such factors as the number of employees and gross sales. According to SBA regulations, SBICs may make long-term loans to small businesses, invest in the equity securities of such businesses, and provide them with consulting and advisory services. Allied Investment provides long-term loans to qualifying small businesses; equity investments and consulting and advisory services are typically provided only in connection with such loans.

Allied Investment is periodically examined and audited by the SBA staff to determine its compliance with SBIC regulations.

Allied Investment has the opportunity to sell to the SBA subordinated debentures with a maturity of up to ten years, up to an aggregate principal amount of $111.7 million. This limit generally applies to all financial assistance provided by the SBA to any licensee and its associates, as that term is defined in SBA regulations. Historically, an SBIC was also eligible to sell preferred stock to the SBA. Allied Investment had received $87.0 million of subordinated debentures and $7.0 million of preferred stock from the SBA at September 30, 2001; as a result of the $111.7 million limit, the Company is limited on its ability to apply for additional financing from the SBA. Interest rates on the SBA debentures currently outstanding have a weighted average interest cost of 8.0%.

DIVIDEND REINVESTMENT PLAN

We have adopted an opt out dividend reinvestment plan (DRIP plan). Under the DRIP plan, if you own shares of common stock registered in your own name, our transfer agent, acting as reinvestment plan agent, will *automatically* reinvest any dividend in additional shares of common stock. Shareholders may change enrollment status in the DRIP plan at any time by contacting either the plan agent or the Company.

A shareholder s ability to participate in a DRIP plan may be limited according to how the shares of common stock are registered. A nominee may preclude beneficial owners holding shares in street name from participating in the DRIP plan. Shareholders who wish to participate in a DRIP plan may need to register their shares of common stock in their own name. Shareholders will be informed of their right to opt out of the DRIP plan in the Company s annual and quarterly reports to shareholders. Shareholders who hold shares in the name of a nominee should contact the nominee for details.

All distributions to investors who do not participate (or whose nominee elects not to participate) in the DRIP plan will be paid by check mailed directly, or through the nominee, to the record holder by or under the discretion of the plan agent. The plan agent is American Stock Transfer and Trust Company, 59 Maiden Lane, New York, New York 10038. Their telephone number is 800-937-5449.

Under the DRIP plan, we may issue new shares unless the market price of the outstanding shares of common stock is less than 110% of the last reported net asset value. Alternatively, the plan agent may buy shares of common stock in the market. We value newly issued shares of common stock for the DRIP plan at the average of the reported last sale prices of the outstanding shares of common stock on the last five trading days prior to the payment date of the distribution, but not less than 95% of the opening bid price on such date. The price in the case of shares bought in the market will be the average actual cost of such shares of common stock, including any brokerage commissions. There are no other fees charged to shareholders in connection with the DRIP plan. Any distributions reinvested under the plan will nevertheless remain taxable to the shareholders.

DESCRIPTION OF SECURITIES

The following summary of the Company s capital stock and other securities does not purport to be complete and is subject to, and qualified in its entirety by, the Company s Amended and Restated Articles of Incorporation, as amended (the Charter). Reference is made to the Charter for a detailed description of the provisions summarized below.

On September 18, 2000, the Board of Directors voted unanimously to amend the Company s Charter to increase its authorized capital stock (the Capital Stock) from 100,000,000 shares, $0.0001 par value, to 200,000,000 shares, and authorized management to hold a special meeting of shareholders on November 15, 2000 to seek shareholder approval for such amendment. The Charter amendment was approved by shareholders and the Charter amendment was filed with the state of Maryland on November 17, 2000.

The Board of Directors may classify and reclassify any unissued shares of Capital Stock of the Company by setting or changing in one or more respects the preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends, qualifications, terms or conditions or redemption or other rights of such shares of Capital Stock.

Common Stock

At December 19, 2001, there were 98,908,464 shares of common stock outstanding and 11,273,787 shares of common stock reserved for issuance under the Amended Stock Option Plan. The following are the outstanding classes of securities of the Company as of December 19, 2001:

	(1) Title of Class	(2) Amount Authorized	(3) Amount Held by Company or for its Account	(4) Amount Outstanding Exclusive of Amounts Shown Under(3)
Allied Capital Corporation	Common Stock	200,000,000		98,908,464

All shares of common stock have equal rights as to earnings, assets, dividends and voting privileges and all outstanding shares of common stock are fully paid and non-assessable. Distributions may be paid to the holders of common stock if and when declared by the Board of Directors out of funds legally available therefore. Our common stock has no preemptive, conversion, or redemption rights and is freely transferable. In the event of liquidation, each share of common stock is entitled to share ratably in all assets of the Company that are legally available for distributions after payment of all debts and liabilities and subject to any prior rights of holders of Preferred Stock, if any, then outstanding. Each share of common stock is entitled to one vote and does not have cumulative voting rights, which means that holders of a majority of the shares, if they so choose, could elect all of the directors, and holders of less than a majority of the shares would, in that case, be unable to elect any director. All shares of common stock offered hereby will be, when issued and paid for, fully paid and non-assessable.

Preferred Stock

In addition to shares of common stock, the articles of incorporation authorizes the issuance of preferred stock (Preferred Stock). The Board of Directors is authorized to provide for the issuance of Preferred Stock with such preferences, powers, rights and privileges as the Board deems appropriate; except that, such an issuance must adhere to the requirements for the 1940 Act. The 1940 Act requires, among other things, that (i) immediately after issuance and before any distribution is made with respect to common stock, the Preferred Stock, together with all other senior securities, must not exceed an amount equal to 50% of the Company s total assets and (ii) the holders of shares of Preferred Stock, if any are issued, must be entitled as a class to elect two directors at all times and to elect a majority of the directors if dividends on the Preferred Stock are in arrears by two years or more. The Company believes the availability of such stock will provide the Company with increased flexibility in structuring future financings and acquisitions. If we offer Preferred Stock under this prospectus, we will issue an appropriate prospectus supplement. You should read that prospectus supplement for a description of the Preferred Stock, including, but not limited to, whether there will be an arrearage in the payment of dividends or sinking fund installments, if any, restrictions with respect to the declaration of dividends, requirements in connection with the maintenance of any ratio or assets, or creation or maintenance of reserves, or provisions for permitting or restricting the issuance of additional securities.

Debt Securities

The Company may issue debt securities that may be senior or subordinated in priority of payment. The Company will provide a prospectus supplement that describes the ranking, whether senior or subordinated, the specific designation, the aggregate principal amount, the purchase price, the maturity, the redemption terms, the interest rate or manner of calculating the interest rate, the time of payment of interest, if any, the terms for any conversion or exchange, including the terms relating to the adjustment of any conversion or exchange mechanism, the listing, if any, on a securities exchange, the name and address of the trustee and any other specific terms of the debt securities.

Limitation on Liability of Directors

The Company has adopted provisions in its charter and bylaws limiting the liability of directors and officers of the Company for monetary damages. The effect of these provisions in the charter and bylaws is to eliminate the rights of the Company and its shareholders (through shareholders derivative suits on behalf of the Company) to recover monetary damages against a director or officers for breach of the fiduciary duty of care as a director or officer (including breaches resulting from negligent or grossly negligent behavior) except in certain limited situations. These provisions do not limit or eliminate the rights of the Company or any shareholder to seek non-monetary relief such as an injunction or rescission in the event of a breach of a director s or officer s duty of care. These provisions will not alter the liability of directors or officers under federal securities laws.

Certain Anti-Takeover Provisions

The charter and bylaws of the Company and certain statutory and regulatory requirements contain certain provisions that could make more difficult the acquisition of the Company by means of a tender offer, a proxy contest or otherwise. These provisions are expected to discourage certain types of coercive takeover practices and inadequate takeover bids and to encourage persons seeking to acquire control of the Company to negotiate first with the board of directors. We believe that the benefits of these provisions outweigh the potential disadvantages of discouraging such proposals because, among other things, negotiation of such proposals might result in an improvement of their terms. The description set forth below is intended as a summary only and is qualified in its entirety by reference to the charter and the bylaws.

Classified Board of Directors

The charter provides for the Board of Directors to be divided into three classes of directors serving staggered three-year terms, with each class to consist as nearly as possible of one-third of the directors then elected to the board. A classified board may render more difficult a change in control of the Company or removal of incumbent management. We believe, however, that the longer time required to elect a majority of a classified board of directors helps to ensure continuity and stability of the Company s management and policies.

Issuance of Preferred Stock

The Board of Directors of the Company, without shareholder approval, has the authority to reclassify authorized but unissued common stock as preferred stock and to issue preferred stock. Such stock could be issued with voting, conversion or other rights designed to have an anti-takeover effect.

Maryland Corporate Law

The Company is subject to the Maryland Business Combination Statute and the Control Share Acquisition Statute, as defined below. The partial summary of the foregoing statutes contained in this prospectus is not intended to be complete and reference is made to the full text of such states for their entire terms.

Business Combination Statute. Certain provisions of the Maryland Law establish special requirements with respect to business combinations between Maryland corporations and interested shareholders unless exemptions are applicable (the Business Combination Statute). Among other things, the Business Combination Statute prohibits for a period of five years a merger or other specified transactions between a company and an interested shareholder and requires a super majority vote for such transactions after the end of such five-year period.

Interested shareholders are all persons owning beneficially, directly or indirectly, 10% or more of the outstanding voting stock of a Maryland corporation. Business combinations include certain mergers or similar transactions subject to a statutory vote and additional transactions involving transfer of assets or securities in specified amounts to interested shareholders or their affiliates.

Unless an exemption is available, a business combination may not be consummated between a Maryland corporation and an interested shareholder or its affiliates for a period of five years after the date on which the shareholder first became an interested shareholder and thereafter may not be consummated unless recommended by the board of directors of the Maryland corporation and approved by the affirmative vote of at least 80% of the votes entitled to be cast by all holders of outstanding shares of voting stock and 66 2/3% of the votes entitled to be cast by all holders of outstanding shares of voting stock other than the interested shareholder or its affiliates or associates, unless, among other things, the corporation s shareholders receive a minimum price (as defined in the Business Combination Statute) for their shares and the consideration is received in cash or in the same form as previously paid by the interested shareholder for its shares.

A business combination with an interested shareholder which is approved by the board of directors of a Maryland corporation at any time before an interested shareholder first becomes an interested shareholder is not subject to the five-year moratorium or special voting requirements. An amendment to a Maryland corporation charter electing not to be subject to the foregoing requirements must be approved by the affirmative vote of at least 80% of the votes entitled to be cast by all holders of outstanding shares of voting stock and 66 2/3% of the votes entitled to be cast by holders of outstanding shares of voting stock who are not interested shareholders. Any such amendment is not effective until 18 months after the vote of shareholders and does not apply to any business combination of a corporation with a shareholder who became an interested shareholder on or prior to the date of such vote.

Control Share Acquisition Statute. The Maryland Law imposes limitations on the voting rights of shares acquired in a control share acquisition. The control share statute defines a control share acquisition to mean the acquisition, directly or indirectly, of control shares subject to certain exceptions. Control shares of a Maryland corporation are defined to be voting shares of stock which, if aggregated with all other shares of stock previously acquired by the acquiror, would entitle the acquiror to exercise voting power in electing directors with one of the following ranges of voting power:

(1) one-tenth or more but not less than one-third;

(2) one-third or more but less than a majority; or

(3) a majority of all voting power.

Control shares do not include shares which the acquiring person is entitled to vote as a result of having previously obtained shareholder approval. Control shares of a Maryland corporation acquired in a control share acquisition have no voting rights except to the extent approved by a vote of two-thirds of the votes entitled to be cast by shareholders in the election of directors, excluding shares of stock as to which the acquiring person, officers of the corporation and directors of the corporation who are employees of the corporation are entitled to exercise or direct the exercise of the voting power of the shares in the election of the directors.

The control share statute also requires Maryland corporations to hold a special meeting at the request of an actual or proposed control share acquiror generally within 50 days after a request is made with the submission of an acquiring person statement, but only if the acquiring person:

(1) gives a written undertaking and, if required by the directors of the issuing corporation, posts a bond for the cost of the meeting; and

(2) submits definitive financing agreements for the acquisition of the control shares to the extent that financing is not provided by the acquiring person.

In addition, unless the issuing corporation s charter or bylaws provide otherwise, the control share statute provides that the issuing corporation, within certain time limitations, shall have the right to redeem control shares (except those for which voting rights have previously been approved) for fair value as determined pursuant to the control share statue in the event:

(1) there is a shareholder vote and the grant of voting rights is not approved; or

(2) an acquiring person statement is not delivered to the target within 10 days following a control share acquisition.

Moreover, unless the issuing corporation s charter or bylaws provide otherwise, the control share statute provides that if, before a control share acquisition occurs, voting rights are accorded to control shares which result in the acquiring person having majority voting power, then all shareholders other than the acquiring person have appraisal rights as provided under the Maryland Law. An acquisition of shares may be exempted from the control share statute provided that a charter or bylaw provision is adopted for such purpose prior to the control share acquisition by any person with respect to the Company. The control share acquisition statute does not apply to shares acquired in a merger, consolidation or share exchange to which the corporation is a party.

Regulatory Restrictions

Allied Investment, a wholly owned subsidiary, is an SBIC. The SBA prohibits, without prior SBA approval, a change of control or transfers which would result in any person (or group of persons acting in concert) owning 10% or more of any class of capital stock of an SBIC. A change of control is any event which would result in a transfer of the power, direct or indirect, to direct the management and policies of an SBIC, whether through ownership, contractual arrangements or otherwise.

PLAN OF DISTRIBUTION

We may offer, from time to time, up to $300,000,000 of our Securities. We may sell the Securities through underwriters or dealers, directly to one or more purchasers, through agents or through a combination of any such methods of sale. Any underwriter or agent involved in the offer and sale of the Securities will be named in the applicable prospectus supplement.

The distribution of the Securities may be effected from time to time in one or more transactions at a fixed price or prices, which may be changed, at prevailing market prices at the time of sale, at prices related to such prevailing market prices, or at negotiated prices, provided, however, that in the case of common stock, the offering price per share, less any underwriting commissions or discounts, must equal or exceed the net asset value (NAV) per share of our common stock at the time of the offering.

In connection with the sale of the Securities, underwriters or agents may receive compensation from the Company or from purchasers of the Securities, for whom they may act as agents, in the form of discounts, concessions or commissions. Underwriters may sell the Securities to or through dealers and such dealers may receive compensation in the form of discounts, concessions or commissions from the underwriters and/or commissions from the purchasers for whom they may act as agents. Underwriters, dealers and agents that participate in the distribution of the Securities may be deemed to be underwriters under the Securities Act, and any discounts and commissions they receive from the Company and any profit realized by them on the resale of the Securities may be deemed to be underwriting discounts and commissions under the Securities Act. Any such underwriter or agent will be identified and any such compensation received from the Company will be described in the applicable prospectus supplement.

Any common stock sold pursuant to a prospectus supplement will be quoted on the New York Stock Exchange, or another exchange on which the common stock is traded.

Under agreements into which the Company may enter, underwriters, dealers and agents who participate in the distribution of the Securities may be entitled to indemnification by the Company against certain liabilities, including liabilities under the Securities Act. Underwriters, dealers and agents may engage in transactions with, or perform services for, the Company in the ordinary course of business.

If so indicated in the applicable prospectus supplement, the Company will authorize underwriters or other persons acting as the Company s agents to solicit offers by certain institutions to purchase the Securities from the Company pursuant to contracts providing for payment and delivery on a future date. Institutions with which such contracts may be made include commercial and savings banks, insurance companies, pension funds, investment companies, educational and charitable institutions and others, but in all cases such institutions must be approved by the Company. The obligations of any purchaser under any such contract will be subject to the condition that the purchase of the Securities shall not at the time of delivery be prohibited under the laws of the jurisdiction to which such purchaser is subject. The underwriters and such other agents will not have any responsibility in respect of the validity or performance of such contracts. Such contracts will be subject only to those conditions set forth in the prospectus supplement, and the prospectus supplement will set forth the commission payable for solicitation of such contracts.

In order to comply with the securities laws of certain states, if applicable, the Securities offered hereby will be sold in such jurisdictions only through registered or licensed brokers or dealers. In addition, in certain states, the Securities may not be sold unless they have been registered or qualified for sale in the applicable state or an exemption from the registration or qualification requirement is available and is complied with.

LEGAL MATTERS

The legality of the Securities offered hereby will be passed upon for the Company by Sutherland Asbill & Brennan LLP, Washington, D.C. Certain legal matters will be passed upon for underwriters, if any, by the counsel named in the prospectus supplement.

SAFEKEEPING, TRANSFER AND DIVIDEND PAYING AGENT

AND REGISTRAR

The Company s and its subsidiaries investments are held in safekeeping by Riggs Bank, N.A. at 808 17th Street, N.W., Washington, D.C. 20006, as well as by LaSalle National Bank, located at 25 Northwest Point Boulevard, Suite 800, Elk Grove Village, Illinois 60007. American Stock Transfer and Trust Company, 59 Maiden Lane, New York, New York 10038 acts as the Company s transfer, dividend paying and reinvestment plan agent and registrar.

INDEPENDENT PUBLIC ACCOUNTANTS

The audited financial statements and schedules included in this prospectus and elsewhere in the registration statement to the extent and for the periods indicated in their reports have been audited by Arthur Andersen LLP, independent public accountants, and are included herein in reliance upon the authority of said firm as experts in giving said reports.

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ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

(in thousands, except number of share amounts)	September 30, 2001	December 31, 2000	December 31, 1999
	(unaudited)		
ASSETS			
Portfolio at value:			
Private finance (cost: 2001-$1,495,587; 2000-$1,262,529; 1999-$639,171)	$1,539,253	$1,282,467	$647,040
Commercial real estate finance (cost: 2001-$633,139; 2000-$503,366; 1999-$522,022)	635,120	505,534	520,029
Small business finance (cost: 2001-$0; 2000-$0; 1999-$61,708)			61,428
Total portfolio at value	2,174,373	1,788,001	1,228,497
Cash and cash equivalents	3,140	2,449	18,155
Other assets	89,320	63,367	43,386
Total assets	$2,266,833	$1,853,817	$1,290,038

LIABILITIES AND SHAREHOLDERS EQUITY

Liabilities:			
Notes payable and debentures	$717,484	$704,648	$487,350
Revolving credit facilities	207,000	82,000	105,500
Accounts payable and other liabilities	35,112	30,477	22,675
Total liabilities	959,596	817,125	615,525
Commitments and Contingencies			
Preferred stock	7,000	7,000	7,000
Shareholders equity:			
Common stock, $0.0001 par value, 200,000,000 shares authorized; 96,920,973, 85,291,696 and 65,930,360 shares issued and outstanding at September 30, 2001, December 31, 2000 and 1999, respectively	10	9	7
Additional paid-in capital	1,293,396	1,043,653	699,148
Common stock held in deferred compensation trust (0 shares, 234,977 shares and 516,779 shares at September 30, 2001, December 31, 2000 and 1999, respectively)			(6,218)
Notes receivable from sale of common stock	(26,250)	(25,083)	(29,461)
Net unrealized appreciation on portfolio	42,842	19,378	4,517
Distributions in excess of earnings	(9,761)	(8,265)	(480)
Total shareholders equity	1,300,237	1,029,692	667,513

Total liabilities and shareholders equity	$2,266,833	$1,853,817	$1,290,038

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF OPERATIONS

(in thousands, except per share amounts)	For the Nine Months Ended September 30, 2001	For the Nine Months Ended September 30, 2000	For the Years Ended December 31, 2000	For the Years Ended December 31, 1999	For the Years Ended December 31, 1998
	(unaudited)	(unaudited)			
Interest and related portfolio income:					
Interest and dividends	$173,722	$129,768	$182,307	$121,112	$80,281
Premiums from loan dispositions	2,070	10,752	16,138	14,284	5,949
Post-Merger gain on securitization of commercial mortgage loans			14,812		
Fees and other income	30,652	9,334	13,144	5,744	5,696
Total interest and related portfolio income	206,444	149,854	211,589	141,140	106,738
Expenses:					
Interest	47,974	41,645	57,412	34,860	20,694
Employee	22,269	19,506	26,025	22,889	18,878
Administrative	10,166	10,711	15,435	12,350	11,921

Total operating expenses	80,409	71,862	98,872	70,099	51,493
Net operating income before net realized and unrealized gains	126,035	77,992	112,717	71,041	55,245
Net realized and unrealized gains:					
Net realized gains	8,339	23,095	15,523	25,391	22,541
Net unrealized gains (losses)	23,463	(267)	14,861	2,138	1,079
Total net realized and unrealized gains	31,802	22,828	30,384	27,529	23,620
Net income before income taxes	157,837	100,820	143,101	98,570	78,865

Income tax expense	787				
Net increase in net assets resulting from operations	$157,837	$100,820	$143,101	$98,570	$78,078
Basic earnings per common share	$1.77	$1.43	$1.95	$1.64	$1.50
Diluted earnings per common share	$1.74	$1.42	$1.94	$1.64	$1.50

Weighted average common shares outstanding basic	89,282	70,604	73,165	59,877	51,941
Weighted average common shares outstanding diluted	90,864	70,777	73,472	60,044	51,974

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 Nine Months Ended September 30,		For the Years Ended December 31,		
	2001	2000	2000	1999	1998
	(unaudited)				
Operations:					
Net operating income before net realized and unrealized gains	$126,035	$77,992	$112,717	$71,041	$55,245
Net realized gains	8,339	23,095	15,523	25,391	22,541
Net unrealized gains (losses)	23,463	(267)	14,861	2,138	1,079
Income tax expense					(787)
Net increase in net assets resulting from operations	157,837	100,820	143,101	98,570	78,078
Shareholder distributions:					
Common stock dividends	(135,702)	(98,617)	(135,795)	(97,941)	(75,087)
Preferred stock dividends	(165)	(165)	(230)	(230)	(230)

Net decrease in net assets resulting from shareholder distributions	(135,867)	(98,782)	(136,025)	(98,171)	(75,317)
Capital share transactions:					
Sale of common stock	237,037	250,912	250,912	164,269	69,675
Issuance of common stock for portfolio investments			86,076		
Issuance of common stock upon the exercise of stock options	7,826	1,467	3,309	5,920	221
Issuance of common stock in lieu of cash distributions	4,879	3,613	4,773	4,610	6,184
Net decrease (increase) in notes receivable from sale of common stock	(1,167)	3,535	4,378	(5,725)	5,576
Net decrease (increase) in common stock held in deferred compensation trust		4,814	6,218	6,972	(13,190)
Other		(563)	(563)	(290)	71
Net increase in net assets resulting from capital share transactions	248,575	263,778	355,103	175,756	68,537

Total increase in net assets	$270,545	$265,816	$362,179	$176,155	$71,298
Net assets at beginning of period	$1,029,692	$667,513	$667,513	$491,358	$420,060
Net assets at end of period	$1,300,237	$933,329	$1,029,692	$667,513	$491,358
Net asset value per common share	$13.42	$11.56	$12.11	$10.20	$8.79
Common shares outstanding at end of period	96,921	80,754	85,057	65,414	55,919

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS

(in thousands)	For the Nine Months Ended September 30, 2001	For the Nine Months Ended September 30, 2000	For the Years Ended December 31, 2000	For the Years Ended December 31, 1999	For the Years Ended December 31, 1998
	(unaudited)				
Cash flows from operating activities:					
Net increase in net assets resulting from operations	$157,837	$100,820	$143,101	$98,570	$78,078
Adjustments					
Net unrealized (gains) losses	(23,463)	267	(14,861)	(2,138)	(1,079)
Post-Merger gain on securitization of commercial mortgages			(14,812)		
Depreciation and amortization	724	659	925	788	702
Amortization of loan discounts and fees	(11,793)	(9,767)	(10,101)	(10,674)	(6,032)
Changes in other assets and liabilities	(8,191)	(8,712)	2,036	(8,712)	11,998
Net cash provided by operating activities	115,114	83,267	121,100	77,834	68,855
Cash flows from investing activities:					

Portfolio investments
(544,024) (675,379) (889,251) (751,871) (524,530)
Repayments of investment principal
52,016 117,940 154,112 145,706 138,081
Proceeds from loan sales
129,980 151,834 280,244 198,368 81,013
Proceeds from securitization of commercial mortgages
223,401
Net redemption of U.S. government securities
11,091
Other investing activities
(125) 3,657 1,417 (1,754) (2,539)

Net cash used in investing activities
(362,153) (401,948) (453,478) (409,551) (73,483)

Cash flows from financing activities:

Sale of common stock
237,037 250,912 250,912 164,269 69,896
Purchase of common stock by deferred compensation trust
(19,431)
Collections of notes receivable from sale of common stock
3,293 4,617 6,363 195 5,591
Common dividends and distributions paid
(130,823) (95,004) (131,022) (95,031) (69,536)
Special undistributed earnings distribution paid
(8,848)
Preferred stock dividends paid
(165) (165) (230) (230) (450)
Net borrowings under (payments on) notes payable and debentures
12,836 89,800 217,298 254,000 (69,471)
Net borrowings under (payments on) revolving lines of credit
125,000 79,500 (23,500) 4,500 56,158
Other financing activities
552 (2,940) (3,149) (2,906) (4,643)

Net cash provided by (used in) financing activities	247,730	326,720	316,672	324,797	(40,734)
Net increase (decrease) in cash and cash equivalents	$691	$8,039	$(15,706)	$(6,920)	$(45,362)
Cash and cash equivalents at beginning of period	$2,449	$18,155	$18,155	$25,075	$70,437
Cash and cash equivalents at end of period	$3,140	$26,194	$2,449	$18,155	$25,075

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)	September 30, 2001 (unaudited) Cost	Value
Ability One Corporation	Loans	$ 10,481	$ 10,481
ACE Products, Inc.	Loans	16,000	16,000
Acme Paging, L.P.	Debt Securities	6,989	6,989
	Limited Partnership Interest	1,456	
Allied Office Products, Inc.	Debt Securities	9,413	8,042
	Warrants	629	
American Barbecue & Grill, Inc.	Warrants	125	
American HomeCare Supply, LLC	Debt Securities	6,892	6,892
	Warrants	579	579
Aspen Pet Products, Inc.	Loans	14,354	14,354
	Preferred Stock (1,860 shares)	1,944	1,944
	Common Stock (1,400 shares)	140	140
ASW Holding Corporation	Warrants	25	25
Aurora Communications, LLC	Loans	15,543	15,543
	Equity Interest	2,461	3,108
Autania AG(1)	Debt Securities	4,340	4,340
	Common Stock (250,000 shares)	2,159	2,159
Avborne, Inc.	Debt Securities	12,787	12,787
	Warrants	1,180	1,180
Bakery Chef, Inc.	Loans	16,733	16,733
Blue Rhino Corporation(1)	Debt Securities	13,796	13,796
	Warrants	1,200	1,200
Border Foods, Inc.	Debt Securities	9,301	9,301
	Preferred Stock (50,919 shares)	2,000	2,000
	Warrants	665	665
Business Loan Express, Inc.	Loan	20,000	20,000
	Debt Securities	60,388	60,388
	Preferred Stock (25,111 shares)	25,111	25,111
	Common Stock (25,503,043 shares)	104,515	120,015
	Guaranty ($50,300 See Note 3)		

Camden Partners Strategic Fund II, L.P.	Limited Partnership Interest	1,068	1,068
CampGroup, LLC	Debt Securities	2,641	2,641
	Warrants	220	220
Candlewood Hotel Company(1)	Preferred Stock (3,250 shares)	3,189	3,189
Celebrities, Inc.	Loan	248	248
	Warrants	12	662
Classic Vacation Group, Inc.(1)	Loan	6,211	6,211

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Private Finance Portfolio Company (in thousands, except number of shares)	Investment(2)	September 30, 2001 (unaudited)	
		Cost	Value
Colibri Holding Corporation	Loans	$ 3,458	$ 3,458
	Common Stock (3,362 shares)	1,250	1,250
	Warrants	290	290
The Color Factory Inc.	Loan	4,833	4,833
	Preferred Stock (600 shares)	600	600
	Common Stock (980 shares)	6,535	6,535
Component Hardware Group, Inc.	Debt Securities	10,655	10,655
	Preferred Stock (18,000 shares)	1,800	1,800
	Common Stock (2,000 shares)	200	200
Convenience Corporation of America	Debt Securities	8,355	2,738
	Preferred Stock (31,521 shares)	334	
	Warrants		
Cooper Natural Resources, Inc.	Debt Securities	1,686	1,686
	Preferred Stock (6,316 shares)	1,427	1,427
	Warrants	832	832
CorrFlex Graphics, LLC	Loan	6,970	6,970
	Debt Securities	5,217	5,217
	Warrants		1,250
	Options		
Coverall North America, Inc.	Loan	10,312	10,312
	Debt Securities	5,248	5,248
	Warrants		
CPM Acquisition Corp.	Loan	9,454	9,454
Csabai Canning Factory Rt.	Hungarian Quotas (9.2%)	700	
CTT Holdings	Loan	1,345	1,345
CyberRep	Loan	1,076	1,076
	Debt Securities	14,093	14,093
	Warrants	660	3,310
The Debt Exchange Inc.	Preferred Stock (921,829 shares)	1,250	1,250
Directory Investment Corporation	Common Stock (470 shares)	112	32
Directory Lending Corporation	Common Stock (50 shares)	30	
Drilltec Patents & Technologies Company, Inc.	Loan	10,918	9,262
	Debt Securities	1,500	1,500
	Warrants		

eCentury Capital Partners, L.P.	Limited Partnership Interest	1,875	1,875
EDM Consulting, LLC	Debt Securities	1,875	443
	Common Stock (100 shares)	250	
El Dorado Communications, Inc.	Loans	306	306
Elexis Beta GmbH	Options	426	526
Eparfin S.A.	Loan	29	29
Esquire Communications Ltd.(1)	Warrants	6	
E-Talk Corporation	Debt Securities	8,852	6,509
	Warrants	1,157	

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Private Finance Portfolio Company (in thousands, except number of shares)	Investment(2)	September 30, 2001 (unaudited) Cost	Value
Executive Greetings, Inc.	Debt Securities	$15,923	$15,923
	Warrants	360	360
ExTerra Credit Recovery, Inc.	Preferred Stock (500 shares)	568	318
	Common Stock (2,500 shares)		
	Warrants		
Fairchild Industrial Products Company	Debt Securities	5,856	5,856
	Warrants	280	2,628
Galaxy American Communications, Inc.	Debt Securities	44,967	45,717
	Options		
Garden Ridge Corporation	Debt Securities	26,890	26,890
	Preferred Stock (1,130 shares)	1,130	1,130
	Common Stock (471 shares)	613	613
Genesis Worldwide, Inc.(1)	Loan	1,067	
Gibson Guitar Corporation	Debt Securities	16,987	16,987
	Warrants	525	2,325
Ginsey Industries, Inc.	Loans	5,000	5,000
	Debentures	500	500
	Warrants		504
Global Communications, LLC	Debt Securities	13,625	13,625
	Equity Interest	11,067	11,067
	Options	1,639	1,639
Grant Broadcasting Systems II	Warrants	87	5,976
Grant Television, Inc.	Equity Interest	660	660
Grotech Partners, VI, L.P.	Limited Partnership Interest	1,179	735
The Hartz Mountain Corporation	Debt Securities	27,363	27,363
	Common Stock (200,000 shares)	2,000	2,000
	Warrants	2,613	2,613
HealthASPex, Inc.	Preferred Stock (1,036,700 shares)	4,140	4,140
	Preferred Stock (414,680 shares)	760	760
	Common Stock (1,451,380 shares)	4	4
HMT, Inc.	Debt Securities	9,961	9,961
	Common Stock (300,000 shares)	3,000	3,000
	Warrants		
Hotelevision, Inc.	Preferred Stock (315,100 shares)	315	315

Icon International, Inc.	Common Stock (37,821 shares)	1,219	1,518
Impact Innovations Group	Debt Securities	6,537	6,537
	Warrants	1,674	1,674
Intellirisk Management Corporation	Loans	22,090	22,090
International Fiber Corporation	Debt Securities	22,115	22,115
	Common Stock (1,029,068 shares)	5,483	5,483
	Warrants	550	550
iSolve Incorporated	Preferred Stock (14,853 shares)	874	
	Common Stock (13,306 shares)	14	
Jakel, Inc.	Loan	19,928	19,928

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

Private Finance Portfolio Company (in thousands, except number of shares)	Investment(2)	September 30, 2001 (unaudited)	
		Cost	Value
JRI Industries, Inc.	Debt Securities	$ 1,967	$ 1,967
	Warrants	74	74
Julius Koch USA, Inc.	Debt Securities	1,375	1,375
	Warrants	259	6,500
Kirker Enterprises, Inc.	Warrants	348	3,494
	Equity Interest	4	11
Kirkland s, Inc.	Debt Securities	7,111	7,111
	Preferred Stock (917 shares)	412	412
	Warrants	96	96
Kyrus Corporation	Debt Securities	7,791	7,791
	Warrants	348	348
Liberty-Pittsburgh Systems, Inc.	Debt Securities	3,485	3,485
	Common Stock (64,535 shares)	142	142
The Loewen Group, Inc.(1)	High-Yield Senior Secured Debt	15,150	13,650
Logic Bay Corporation	Preferred Stock (1,131,222 shares)	5,000	5,000
Love Funding Corporation	Preferred Stock (26,000 shares)	359	213
Magna Card, Inc.	Debt Securities	153	153
	Preferred Stock (1,875 shares)	94	94
	Common Stock (4,687 shares)		
Master Plan, Inc.	Loan	1,204	1,204
	Common Stock (156 shares)	42	2,042
MedAssets.com, Inc.	Preferred Stock (260,417 shares)	2,049	2,049
	Warrants	136	136
Mid-Atlantic Venture Fund IV, L.P.	Limited Partnership Interest	2,475	1,989
Midview Associates, L.P.	Warrants		
Monitoring Solutions, Inc.	Debt Securities	1,823	153
	Common Stock (33,333 shares)		
	Warrants		
MortgageRamp.com, Inc.	Common Stock (800,000 shares)	4,000	4,000
Morton Grove Pharmaceuticals, Inc.	Loan	15,946	15,946
	Preferred Stock (106,947 shares)	5,000	9,000

Most Confiserie GmbH & Co KG	Loan	965	965
MVL Group, Inc.	Debt Securities	16,213	16,213
	Warrants	643	643
NETtel Communications, Inc.	Debt Securities	13,483	6,483
Nobel Learning Communities, Inc.(1)	Debt Securities	9,637	9,637
	Preferred Stock (265,957 shares)	2,000	2,000
	Warrants	575	575
North American Archery, LLC	Loans	3,612	2,848
	Debentures	26	0
Northeast Broadcasting Group, L.P.	Debt Securities	321	321

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Private Finance Portfolio Company (in thousands, except number of shares)	Investment(2)	September 30, 2001 (unaudited) Cost	Value
Novak Biddle Venture Partners III, LP	Limited Partnership Interest	$ 330	$ 330
Nursefinders, Inc.	Debt Securities	11,075	11,075
	Warrants	900	900
Onyx Television GmbH	Preferred Units (600,000 shares)	201	201
Opinion Research Corporation(1)	Debt Securities	14,146	14,146
	Warrants	996	996
Oriental Trading Company, Inc.	Loan	128	128
	Debt Securities	12,650	12,650
	Preferred Equity Interest	1,500	1,822
	Common Equity Interest		
	Warrants	13	266
Outsource Partners, Inc.	Debt Securities	23,890	23,890
	Warrants	826	826
Packaging Advantage Corporation	Debt Securities	11,563	11,563
	Common Stock (200,000 shares)	2,000	2,000
	Warrants	963	963
Physicians Specialty Corporation	Debt Securities	39,580	39,580
	Common Stock (79,567,042 shares)	1,000	100
Pico Products, Inc.(1)	Loan	1,300	1,300
	Debt Securities	4,591	1,591
	Common Stock (208,000 shares)	59	
	Warrants		
Polaris Pool Systems, Inc.	Debt Securities	6,556	6,556
	Warrants	1,050	1,050
Powell Plant Farms, Inc.	Loan	16,809	16,809
Proeducation GmbH	Loan	136	136
Professional Paint, Inc.	Debt Securities	21,409	21,409
	Preferred Stock (15,000 shares)	15,000	15,000
	Common Stock (110,000 shares)	69	69
Progressive International Corporation	Debt Securities	3,956	3,956
	Preferred Stock (500 shares)	500	500
	Common Stock (197 shares)	13	13
	Warrants		
Prosperco Finaz Holding AG	Debt Securities	5,262	5,262
	Common Stock (1,528 shares)	1,059	1,059

	Warrants		
Raytheon Aerospace, LLC	Debt Securities	5,013	5,013
	Common LLC Interest		
Redox Brands, Inc.	Debt Securities	9,368	9,368
	Warrants	584	584
Schwinn Holdings Corporation	Debt Securities	10,206	1,835
	Warrants	395	
Seasonal Expressions, Inc.	Preferred Stock (1,000 shares)	500	
Simula, Inc.	Loan	24,875	24,875

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Private Finance Portfolio Company (in thousands, except number of shares)	Investment(2)	September 30, 2001 (unaudited) Cost	Value
Soff-Cut Holdings, Inc.	Debt Securities	$ 8,623	$ 8,623
	Preferred Stock (300 shares)	300	300
	Common Stock (2,000 shares)	200	200
	Warrants	446	446
Southern Communications, LLC	Equity Interest	9,778	9,778
Southwest PCS, LLC	Loan	8,088	8,088
Spa Lending Corporation	Preferred Stock (28,625 shares)	470	368
	Common Stock (6,208 shares)	25	15
Staffing Partners Holding Company, Inc.	Debt Securities	4,991	4,991
	Preferred Stock (414,600 shares)	2,073	2,073
	Common Stock (50,200 shares)	50	50
	Warrants	10	10
Startec Global Communications Corporation(1)	Debt Securities	20,742	20,742
	Loan	15,156	15,156
	Common Stock (258,064 shares)	3,000	
	Warrants		
STS Operating, Inc.	Common Stock (3,000,000 shares)	3,177	3,177
SunSource Inc.	Debt Securities	39,819	39,819
	Common Stock (6,890,937 shares)	58,647	58,647
SunStates Refrigerated Services, Inc.	Loans	6,062	4,573
	Debt Securities	2,445	877
Sure-Tel, Inc.	Loan	207	207
	Preferred Stock (1,116,902 shares)	4,624	4,624
	Warrants	662	662
	Options		
Sydran Food Services II, L.P.	Debt Securities	12,973	12,973
Total Foam, Inc.	Debt Securities	264	127
	Common Stock (910 shares)	10	
Tubbs Snowshoe Company, LLC	Debt Securities	3,910	3,910
	Warrants	54	54
	Equity Interests	500	500
United Pet Group, Inc.	Debt Securities	4,964	4,964
	Warrants	15	15
Updata Venture Partners, II, L.P.	Limited Partnership Interest	1,900	1,900

Velocita, Inc.	Debt Securities	11,638	11,638
	Warrants	3,540	3,540
Venturehouse Group, LLC	Common Equity Interest	667	459
Walker Investment Fund II, LLLP	Limited Partnership Interest	1,000	638
Warn Industries, Inc.	Debt Securities	18,663	18,663
	Warrants	1,429	3,129
Williams Brothers Lumber Company	Warrants	24	322
Wilmar Industries, Inc.	Debt Securities	32,596	32,596
	Warrants	3,169	3,169

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Private Finance Portfolio Company (in thousands, except number of shares)	**Investment(2)**	**September 30, 2001 (unaudited)**	
		Cost	**Value**
Wilshire Restaurant Group, Inc.	Debt Securities	$ 15,464	$ 15,464
	Warrants		
Wilton Industries, Inc.	Loan	12,000	12,000
Woodstream Corporation	Debt Securities	7,620	7,620
	Equity Interests	1,700	2,372
	Warrants	450	628
Wyo-Tech Acquisition Corporation	Debt Securities	12,579	12,579
	Preferred Stock (100 shares)	3,700	3,700
	Common Stock (99 shares)	100	44,100
Total private finance (132 investments)		$ 1,495,587	$ 1,539,253

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(in thousands, except number of loans)	Interest Rate Ranges	Number of Loans	September 30, 2001 (unaudited) Cost	Value
Commercial Real Estate Finance				
Commercial Mortgage Loans	Up to 6.99%	4	$ 942	$ 2,642
	7.00% 8.99%	21	40,057	42,158
	9.00% 10.99%	21	17,334	17,240
	11.00% 12.99%	12	11,641	11,641
	13.00% 14.99%	8	12,727	12,453
	15.00% and above	2	88	64
Total commercial mortgage loans		68	$82,789	$86,198

	Stated Interest	Face	Cost	Value
Purchased CMBS				
Mortgage Capital Funding, Series 1998-MC3	5.5%	$54,491	$26,640	$26,640
Morgan Stanley Capital I, Series 1999-RM1	6.4%	51,046	21,468	21,468
COMM 1999-1	5.6%	74,879	35,402	35,402
Morgan Stanley Capital I, Series 1999-FNV1	6.1%	45,527	22,231	22,231
DLJ Commercial Mortgage Trust 1999-CG2	6.1%	96,432	44,732	44,732
Commercial Mortgage Acceptance Corp., Series 1999-C1	6.8%	34,856	16,344	16,344
LB Commercial Mortgage Trust, Series 1999-C2	6.7%	29,005	11,236	11,236
Chase Commercial Mortgage Securities Corp., Series 1999-2	6.5%	43,046	20,742	20,742
FUNB CMT, Series 1999-C4	6.5%	49,287	22,502	22,502