ALLIED CAPITAL CORP
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PROSPECTUS SUPPLEMENT
(To Prospectus dated April 27, 2006)

2,350,000 Shares

Common Stock

We are offering 2,350,000 shares of our common stock, par value $0.0001 per share. We will receive all of the net proceeds from the sale of our common stock.

Our common stock is traded on the New York Stock Exchange under the symbol ALD. The last reported sale price for our common stock on November 28, 2006, was $30.49 per share. We sold the shares of common stock for $28.58 per share, which is an approximate 6.25% discount off the last reported sale price on November 28, 2006.

Please read this prospectus supplement, and the accompanying prospectus, before investing, and keep it for future reference. The prospectus supplement and the accompanying prospectus contain important information about us that a prospective investor should know before investing in our common stock. We file annual, quarterly and current reports, proxy statements and other information about us with the Securities and Exchange Commission. This information is available free of charge by contacting us at 1919 Pennsylvania Avenue, NW, Washington, DC, 20006, or by telephone at (202) 721-6100 or on our website at www.alliedcapital.com. The information on this website is not incorporated by reference into this prospectus supplement and the accompanying prospectus. The SEC also maintains a website at www.sec.gov that contains such information.

Before buying any of these shares of our common stock, you should review the information, including the risk of leverage, set forth under Risk Factors on page 10 of the accompanying prospectus.

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 accompanying prospectus. Any representation to the contrary is a criminal offense.

	Per Share	Total
Public offering price	$ 29.75	$ 69,912,500
Underwriting discount	$ 1.17	$ 2,749,500
Proceeds, before expenses, to us[1]	$ 28.58	$ 67,163,000

(1) Expenses payable by us are estimated to be approximately $350,000.

The underwriters may also purchase from us up to an additional 352,500 shares of our common stock at the public offering price less the underwriting discount, to cover over-allotments, if any, within 30 days of the date of this prospectus supplement.

The underwriters are offering the shares of our common stock as described in Underwriting. Delivery of the shares will be made on or about December 4, 2006.

Deutsche Bank Securities

The date of this prospectus supplement is November 28, 2006

You should rely only on the information contained in this prospectus supplement and the accompanying prospectus. We have not, and the underwriters have not, authorized any other person to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. We are not, and the underwriters are not, making an offer to sell these securities in any jurisdiction where the offer or sale is not permitted. You should assume that the information appearing in this prospectus supplement and the accompanying prospectus is accurate only as of their respective dates. Our business, financial condition and results of operations may have changed since those dates. This prospectus supplement supersedes the accompanying prospectus to the extent it contains information that is different from or additional to the information in that prospectus.

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

Information contained in this prospectus supplement and the accompanying 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 accompanying prospectus and certain other factors noted throughout this prospectus supplement and the accompanying prospectus 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.

FEES AND EXPENSES

This table describes the various costs and expenses that an investor in our shares of common stock will bear directly or indirectly.

Shareholder Transaction Expenses	
Sales load (as a percentage of offering price)(1)	3.9%
Dividend reinvestment plan fees(2)	None
Annual Expenses (as a percentage of consolidated net assets attributable to common stock)(3)	
Operating expenses(4)	5.3%
Interest payments on borrowed funds(5)	3.6%
Total annual expenses(6)(7)	8.9%

(1) Represents the underwriting discounts or commissions with respect to the shares sold by us in this offering.

(2) The expenses of our dividend reinvestment plan are included in Operating expenses. We do not have a stock purchase plan. The participants in the dividend reinvestment plan will bear a pro rata share of brokerage commissions incurred with respect to open market purchases or sales, if any. See Dividend Reinvestment Plan in the accompanying prospectus.

(3) Consolidated net assets attributable to common stock equals net assets (*i.e.*, total consolidated assets less total consolidated liabilities), which at September 30, 2006, was $2.8 billion.

(4) Operating expenses represent our estimated operating expenses for the year ending December 31, 2006, excluding interest on indebtedness. Estimated operating expenses for the year ending December 31, 2006, exclude any expense related to option cancellation payments (OCP) described below under Interim Management s Discussion and Analysis of Financial Condition and Results of Operations. This percentage for the year ended December 31, 2005, was 5.7%. See Management and Compensation of Executive Officers and Directors in the accompanying prospectus.

(5) Interest payments on borrowed funds represents our estimated interest expense for the year ending December 31, 2006. We had outstanding borrowings of $1.6 billion at September 30, 2006. This percentage for the year ended December 31, 2005, was 2.9%. See Risk Factors in the accompanying 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. We borrow money to leverage our net assets and increase our total assets. The SEC 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, our Total annual expenses would be 5.5% of consolidated total assets.

(7) The holders of shares of our common stock (and not the holders of our debt securities or preferred stock, if any) indirectly bear the cost associated with our annual expenses.

Example

The following example, required by the SEC, demonstrates the projected dollar amount of total cumulative expenses that would be incurred over various periods with respect to a hypothetical investment in us. 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 5.0% annual return	$ 126	$ 298	$ 468	$ 887

Although the example assumes (as required by the SEC) 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 dividend reinvestment plan may receive shares of common stock that we issue at or above net asset value or are purchased by the administrator of the dividend reinvestment plan, at the market price in effect at the time, which may be higher than, at, or below net asset value.

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

USE OF PROCEEDS

We estimate that our net proceeds from the sale of the 2,350,000 shares of common stock we are offering will be approximately $66.8 million and approximately $76.9 million, if the underwriters over-allotment option is exercised in full, and after deducting the underwriting discount and estimated offering expenses payable by us.

We expect to use the net proceeds from this offering to reduce borrowings under our revolving line of credit, to invest in debt or equity securities in primarily privately negotiated transactions, and for other general corporate purposes. Amounts repaid under our revolving line of credit will remain available for future borrowings. At November 27, 2006, the interest rate on our revolving line of credit was approximately 6.4% and there was approximately $370 million outstanding. This revolving line of credit expires on September 30, 2008.

UNDERWRITING

Subject to the terms and conditions set forth in our underwriting agreement, we are offering the shares of our common stock described in this prospectus supplement through Deutsche Bank Securities Inc., the underwriter. The underwriter has agreed to purchase and we have agreed to sell to the underwriter, all of the shares offered by this prospectus supplement.

The underwriting agreement provides that the obligation of the underwriter to purchase the shares of common stock offered hereby is subject to certain conditions precedent and that the underwriter will purchase all of the shares of common stock offered by this prospectus supplement, other than those covered by the over-allotment option described below, if any of these shares are purchased.

The underwriter proposes to offer the shares of common stock to the public at the public offering price set forth on the cover of this prospectus supplement. If all the shares are not sold at the public offering price, the underwriter may change the offering price.

The underwriter has the option to purchase up to 352,500 additional shares of common stock from us at the same price it is paying for the 2,350,000 shares offered hereby. The underwriter may purchase additional shares only to cover over-allotments made in connection with this offering and only within 30 days after the date of this prospectus supplement. The underwriter will offer any additional shares that it purchases on the terms described in the preceding section.

The underwriting discount per share is equal to the public offering price per share of common stock less the amount paid by the underwriter to us per share of common stock. These amounts are shown assuming either no exercise or full exercise by the underwriter of the underwriter s over-allotment option:

		Total Fees	
	Fee Per Share	**Without Exercise of Over-Allotment Option**	**With Full Exercise of Over-Allotment Option**
Underwriting discount	$ 1.17	$ 2,749,500	$ 3,161,925

We estimate that the total expenses of this offering, which will be paid by us, excluding the underwriting discount, will be approximately $350,000.

We have agreed to indemnify the underwriter against some specified types of liabilities, including liabilities under the Securities Act, and to contribute to payments the underwriter may be required to make in respect of these liabilities.

We and certain of our executive officers have agreed not to offer, sell, contract to sell or otherwise dispose of, or to engage in certain hedging and derivative transactions with respect to, our common stock for a period of 30 days after the date of this prospectus supplement without first obtaining the written consent of Deutsche Bank Securities Inc., except in limited circumstances, including our additional issuance of equity securities through privately negotiated transactions that may or may not involve an underwriter, whether or not registered with the SEC, aggregating not more than $75 million, and the additional issuance of equity securities in exchange for the cancellation of vested in-the-money stock options in connection with the option cancellation payments (see Interim Management s Discussion and Analysis of Financial Condition and Results of Operations). This consent may be given at any time

without public notice.

The underwriter does not intend to confirm sales to any account over which they exercise discretionary authority.

In connection with this offering, the underwriter may purchase and sell shares of our common stock in the open market. These transactions may include stabilizing transactions, short sales and purchases to cover positions created by short sales and stabilizing transactions.

Short sales involve the sale by the underwriter of a greater number of shares than it is required to purchase in this offering. Covered short sales are sales made in an amount not greater than the underwriter s over-allotment option to purchase additional shares in this offering. The underwriter may close out any covered short position by either exercising its over-allotment option or purchasing shares in the open market. In determining the source of shares to close out the covered short position, the underwriter will consider, among other things, the price of shares available for purchase in the open market as compared to the price at which they may purchase shares through the over-allotment option.

Naked short sales are sales in excess of the over-allotment option. The underwriter must close out any naked short position by purchasing shares in the open market. A naked short position is more likely to be created if the underwriter is concerned there may be downward pressure on the price of shares in the open market prior to the completion of this offering.

Stabilizing transactions consist of various bids for or purchases of our common stock made by the underwriter in the open market prior to the completion of this offering.

Purchases to cover a short position and stabilizing transactions may have the effect of preventing or slowing a decline in the market price of our common stock. Additionally, these purchases may stabilize, maintain or otherwise affect the market price for our common stock. As a result, the price of our common stock may be higher than the price that might otherwise exist in the open market. These transactions may be effected on the New York Stock Exchange, in the over-the-counter market or otherwise.

In the ordinary course of business, the underwriter or its affiliates have engaged and may in the future engage in various financing, commercial banking and investment banking services with, and provide financial advisory services to, us and our affiliates, for which they have received or may receive customary fees and expenses. Affiliates of Deutsche Bank Securities Inc. are members of the lending syndicate for our unsecured revolving line of credit and may receive proceeds of this offering by reason of the repayment of amounts outstanding thereunder.

This offering is being conducted in compliance with Rule 2810 of the Conduct Rules of the National Association of Securities Dealers, Inc.

The principal business address of Deutsche Bank Securities Inc. is 60 Wall Street, 44th Floor, New York, NY 10005.

LEGAL MATTERS

Certain legal matters with respect to the validity of the shares of common stock we are offering will be passed upon for us by Sutherland Asbill & Brennan LLP, Washington, D.C. Certain legal matters related to the offering will be passed upon for the underwriter by Fried, Frank, Harris, Shriver & Jacobson LLP, Washington D.C.

**INTERIM MANAGEMENT S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following analysis of the financial condition and results of operations of the Company should be read in conjunction with the Company s Consolidated Financial Statements and the Notes thereto included herein, in the accompanying prospectus, and in the Company s annual report on Form 10-K for the year ended December 31, 2005. In addition, this prospectus supplement and the accompanying prospectus contain certain forward-looking statements. These statements include the plans and objectives of management for future operations and financial objectives and 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. These forward-looking statements are subject to the inherent uncertainties in predicting future results and conditions. Certain factors that could cause actual results and conditions to differ materially from those projected in these forward-looking statements are set forth in the Risk Factors section in the accompanying prospectus. Other factors that could cause actual results to differ materially include:

- *changes in the economy and general economic conditions;*
- *risks associated with possible disruption in our operations due to terrorism;*
- *future changes in laws or regulations and conditions in our operating areas; and*
- *other risks and uncertainties as may be detailed from time to time in our public announcements and SEC filings.*

Financial or other information presented for private finance portfolio companies has been obtained from the portfolio companies, and the financial information presented may represent unaudited, projected or pro forma financial information, and therefore may not be indicative of actual results. In addition, the private equity industry uses financial measures such as EBITDA or EBITDAM (Earnings Before Interest, Taxes, Depreciation, Amortization and, in some instances, Management fees) in order to assess a portfolio company s financial performance and to value a portfolio company. EBITDA and EBITDAM are not intended to represent cash flow from operations as defined by U.S. generally accepted accounting principles and such information should not be considered as an alternative to net income, cash flow from operations or any other measure of performance prescribed by U.S. generally accepted accounting principles.

OVERVIEW

As a business development company, we are in the private equity business. Specifically, we provide long-term debt and equity investment capital to companies in a variety of industries. Our lending and investment activity has generally been focused on private finance and commercial real estate finance, which included primarily the investment in non-investment grade commercial mortgage-backed securities, which we refer to as CMBS, and collateralized debt obligation bonds and preferred shares, which we refer to as CDOs.

On May 3, 2005, we completed the sale of our portfolio of CMBS and real estate related CDO investments. Upon the completion of this transaction, our lending and investment activity has been focused primarily on private finance investments. Our private finance activity principally involves providing financing to middle market U.S. companies through privately negotiated long-term debt and equity investment capital. Our financing is generally used to fund growth, acquisitions, buyouts, recapitalizations, note purchases, bridge financings, and other types of financings. We generally invest in private companies though, from time to time, we may invest in companies that are public but lack access to additional public capital. Our investment objective is to achieve current income and capital gains.

Our portfolio composition at September 30, 2006 and 2005, and at December 31, 2005, was as follows:

	September 30,		December 31,
	2006	2005	2005
Private finance	97%	96%	96%
Commercial real estate finance	3%	4%	4%

Our earnings depend primarily on the level of interest and dividend income, fee and other income, and net realized and unrealized gains or losses on our investment portfolio after deducting interest expense on borrowed capital, operating expenses and income taxes including excise tax. Interest income results from the stated interest rate earned on a loan or debt security and the amortization of loan origination fees and discounts. The level of interest income is directly related to the balance of the interest-bearing investment portfolio outstanding during the period multiplied by the weighted average yield. Our ability to generate interest income is dependent on economic, regulatory, and competitive factors that influence new investment activity, interest rates on the types of loans we make, the level of repayments in the portfolio, the amount of loans and debt securities for which interest is not accruing and our ability to secure debt and equity capital for our investment activities.

Because we are a regulated investment company for tax purposes, we intend to distribute substantially all of our annual taxable income as dividends to our shareholders. See Other Matters below.

PORTFOLIO AND INVESTMENT ACTIVITY

The total portfolio at value, investment activity, and the yield on interest-bearing investments at and for the three and nine months ended September 30, 2006 and 2005, and at and for the year ended December 31, 2005, were as follows:

($ in millions)	At and for the Three Months Ended September 30, 2006	At and for the Three Months Ended September 30, 2005	At and for the Nine Months Ended September 30, 2006	At and for the Nine Months Ended September 30, 2005	At and for the Year Ended December 31, 2005
Portfolio at value	$ 4,119.6	$ 3,223.8	$ 4,119.6	$ 3,223.8	$ 3,606.4
Investments funded[1]	$ 629.5	$ 673.4	$ 1,880.8	$ 1,328.2	$ 1,675.8
Change in accrued or reinvested interest and dividends[2]	$ 7.2	$ 5.5	$ (1.8)	$ 1.9	$ 6.6
Principal collections related to investment repayments or sales	$ 116.3	$ 151.0	$ 885.9	$ 1,241.8	$ 1,503.4
Yield on interest-bearing investments[3]	12.3%	12.6%	12.3%	12.6%	12.8%

(1) Investments funded for the nine months ended September 30, 2006, included a $150 million subordinated debt investment in Advantage Sales & Marketing, Inc. received in conjunction with the sale of Advantage and a $30 million subordinated debt investment in STS Operating, Inc. received in conjunction with the sale of STS. See discussion below. Investments funded also include investments acquired through the issuance of our common stock as consideration totaling zero and $7.2 million for the nine months ended September 30, 2006 and 2005, respectively, and $7.2 million for the year ended December 31, 2005.

(2)

Includes changes in accrued or reinvested interest of $1.3 million and $3.0 million for the three and nine months ended September 30, 2006, respectively, related to our investments in money market securities.

(3) The weighted average yield on interest-bearing investments is computed as the (a) annual stated interest on accruing loans and debt securities plus the annual amortization of loan origination fees, original issue discount, and market discount on accruing loans and debt securities less the annual amortization of loan origination costs, divided by (b) total interest-bearing investments at value. The weighted average yield is computed as of the balance sheet date.

Private Finance

The private finance portfolio at value, investment activity, and the yield on loans and debt securities at and for the three and nine months ended September 30, 2006 and 2005, and at and for the year ended December 31, 2005, 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 Year Ended December 31,	
	2006		2005		2006		2005		2005	
millions)	Value	Yield[2]	Value	Yield[2]	Value	Yield[2]	Value	Yield[2]	Value	Yiel
olio at value:										
s and debt ities:										
r loans	$ 342.4	8.7%	$ 255.9	8.6%	$ 342.4	8.7%	$ 255.9	8.6%	$ 239.8	9
anche debt	745.8	11.2%	197.2	11.8%	745.8	11.2%	197.2	11.8%	294.2	11
rdinated debt	1,817.0	13.7%	1,586.5	13.8%	1,817.0	13.7%	1,586.5	13.8%	1,560.9	13
loans and debt ities	$ 2,905.2	12.5%	$ 2,039.6	13.0%	$ 2,905.2	12.5%	$ 2,039.6	13.0%	$ 2,094.9	13
y securities	1,082.6		1,041.4		1,082.6		1,041.4		1,384.4	
portfolio	$ 3,987.8		$ 3,081.0		$ 3,987.8		$ 3,081.0		$ 3,479.3	
tments funded[1]	$ 629.2		$ 665.7		$ 1,866.6		$ 1,131.9		$ 1,462.3	
ge in accrued or ested interest and ends	$ 5.8		$ 5.9		$ (5.4)		$ 20.4		$ 24.6	
ipal collections d to investment ments or sales	$ 115.6		$ 146.5		$ 868.0		$ 476.5		$ 703.9	

(1) Investments funded for the nine months ended September 30, 2006, included a $150 million subordinated debt investment in Advantage Sales & Marketing, Inc. received in conjunction with the sale of Advantage and a $30 million subordinated debt investment in STS Operating, Inc. received in conjunction with the sale of STS. See discussion below.

(2) The weighted average yield on loans and debt securities is computed as the (a) annual stated interest on accruing loans and debt securities plus the annual amortization of loan origination fees, original issue discount, and market discount on accruing loans and debt securities less the annual amortization of loan origination costs, divided by (b) total loans and debt securities at value. The weighted average yield is computed as of the balance sheet date.

Our investment activity is focused on making long-term investments in the debt and equity of primarily private middle market companies. Debt investments may include senior loans, unitranche debt (a single debt investment that is a blend of senior and subordinated debt), or subordinated debt (with or without equity features). The junior debt that we invest in that is lower in repayment priority than senior debt is also known as mezzanine debt. Equity investments may include a minority equity stake in connection with a debt investment or a substantial equity stake in connection with a buyout transaction. In a buyout transaction, we generally invest in senior and/or subordinated debt and equity (preferred and/or voting or non-voting common) where our equity ownership represents a significant portion of the

equity, but may or may not represent a controlling interest.

In addition, we may fund most or all of the debt and equity capital upon the closing of certain buyout transactions, which may include investments in lower-yielding senior debt. Subsequent to the closing, the portfolio company may refinance all or a portion of the lower-yielding senior debt, which would reduce our investment. Repayments include repayments of senior debt funded by us that was subsequently refinanced or repaid by the portfolio companies.

We intend to take a balanced approach to private equity investing that emphasizes a complementary mix of debt investments and buyout investments. The combination of these two types of investments provides current interest and related portfolio income and the potential for future capital gains. To address the current market, our strategy is to focus on buyout and recapitalization transactions where we can manage risk through the structure and terms of our debt and equity investments and where we can potentially realize more attractive total returns from both current interest and fee income and future capital gains. We are also focusing our debt investing on smaller middle market companies where we can provide both senior and subordinated debt or unitranche debt, where our combined current yield may be lower than traditional subordinated debt only. We believe that providing both senior and subordinated debt or unitranche debt provides us with greater protection in the capital structures of our portfolio companies.

Investments Funded. Investments funded and the weighted average yield on investments funded for the nine months ended September 30, 2006 and 2005, and for the year ended December 31, 2005, consisted of the following:

	For the Nine Months Ended September 30, 2006					
	Debt Investments		Buyout Investments		Total	
($ in millions)	Amount	Weighted Average Yield[1]	Amount	Weighted Average Yield[1]	Amount	Weighted Average Yield[1]
Loans and debt securities:						
Senior loans[4]	$ 202.4	9.4%	$ 167.3	8.8%	$ 369.7	9.1%
Unitranche debt[2]	348.7	10.6%	146.5	12.9%	495.2	11.3%
Subordinated debt[3]	508.0	13.1%	250.8	13.9%	758.8	13.3%
Total loans and debt securities	1,059.1	11.5%	564.6	12.1%	1,623.7	11.8%
Equity	62.9		180.0		242.9	
Total	$ 1,122.0		$ 744.6		$ 1,866.6	

	For the Nine Months Ended September 30, 2005					
	Debt Investments		Buyout Investments		Total	
($ in millions)	Amount	Weighted Average Yield[1]	Amount	Weighted Average Yield[1]	Amount	Weighted Average Yield[1]
Loans and debt securities:						
Senior loans	$ 50.7	10.6%	$ 186.8	6.0%	$ 237.5	7.0%
Unitranche debt[2]	154.9	10.5%			154.9	10.5%
Subordinated debt	239.0	12.6%	313.9	12.6%	552.9	12.6%
Total loans and debt securities	444.6	11.7%	500.7	10.2%	945.3	10.9%
Equity	23.9		162.7		186.6	
Total	$ 468.5		$ 663.4		$ 1,131.9	

(1) The weighted average yield on loans and debt securities is computed as the (a) annual stated interest on accruing loans and debt securities, divided by (b) total loans and debt securities funded.

(2) Unitranche debt is a single debt investment that is a blend of senior and subordinated debt terms. The yield on a unitranche investment reflects the blended yield of senior and subordinated debt combined.

(3) Debt investments for the nine months ended September 30, 2006, included a $150 million, 12.0% subordinated debt investment in Advantage Sales & Marketing, Inc. received in conjunction with the sale of Advantage and a $30 million, 15.0% subordinated debt investment in STS Operating, Inc. received in conjunction with the sale of STS. See discussion below.

(4)

Senior loans funded for the nine months ended September 30, 2006, included $192.2 million that was repaid during the nine months ended September 30, 2006.

	For the Year Ended December 31, 2005					
	Debt Investments		Buyout Investments		Total	
($ in millions)	Amount	Weighted Average Yield(1)	Amount	Weighted Average Yield(1)	Amount	Weighted Average Yield(1)
Loans and debt securities:						
Senior loans(3)	$ 76.8	10.0%	$ 250.2	6.4%	$ 327.0	7.2%
Unitranche debt(2)	259.5	10.5%			259.5	10.5%
Subordinated debt	296.9	12.3%	330.9	12.5%	627.8	12.4%
Total loans and debt securities	633.2	11.3%	581.1	9.9%	1,214.3	10.6%
Equity	82.5		165.5		248.0	
Total	$ 715.7		$ 746.6		$ 1,462.3	

(1) The weighted average yield on loans and debt securities is computed as the (a) annual stated interest on accruing loans and debt securities, divided by (b) total loans and debt securities funded.

(2) Unitranche debt is a single debt investment that is a blend of senior and subordinated debt terms. The yield on a unitranche investment reflects the blended yield of senior and subordinated debt combined.

(3) Buyout senior loans funded included $174.9 million that was repaid during 2005 and $14.1 million that was repaid during the nine months ended September 30, 2006.

We generally fund new investments using cash. In addition, we may acquire securities in exchange for our common equity. Also, we may acquire new securities through the reinvestment of previously accrued interest and dividends in debt or equity securities, or the current reinvestment of interest and dividend income through the receipt of a debt or equity security (payment-in-kind income). From time to time we may opt to reinvest accrued interest receivable in a new debt or equity security in lieu of receiving such interest in cash.

The level of investment activity for investments funded and principal repayments for private finance investments can vary substantially from period to period depending on the number and size of investments that we make or that we exit and many other factors, including the amount of debt and equity capital available to middle market companies, the level of merger and acquisition activity for such companies, the general economic environment, and the competitive environment for the types of investments we make. We believe that merger and acquisition activity in the middle market is strong, which has resulted in an increase in private finance investment opportunities, as well as increased repayments. We continue to have an active pipeline of new investments under consideration. We believe that merger and acquisition activity for middle market companies will remain strong for the remainder of 2006 and into 2007.

Through our wholly owned subsidiary, AC Finance LLC (AC Finance), we generally originate, underwrite and arrange senior loans. Senior loans originated and underwritten by AC Finance may or may not be funded by us at closing. When these senior loans are closed, we may fund all or a portion of the underwritten commitment pending sale of the loan to other investors, which may include loan sales to Callidus Capital Corporation (Callidus) or funds managed by Callidus, a portfolio company controlled by us. After completion of the sale process, we may or may not retain a position in these senior loans. AC Finance generally earns a fee on the senior loans originated and underwritten whether or not we fund the underwritten commitment.

Yield. The weighted average yield on private finance loans and debt securities was 12.5% at September 30, 2006, as compared to 13.0% at both September 30, 2005 and December 31, 2005. The weighted average yield on the private finance loans and debt securities may fluctuate from period to period, depending on the yield on new loans and debt securities funded, the yield on loans and debt securities repaid, the amount of loans and debt securities for which interest is not accruing (see Portfolio Asset Quality Loans and Debt Securities on Non-Accrual Status below) and the amount of lower-yielding senior or unitranche debt in the portfolio at the end of the period. The yield on the private finance portfolio has declined partly due to our strategy to pursue investments where our position in the portfolio company capital structure is more senior, such as senior debt and unitranche investments. These investments typically have lower yields than subordinated debt investments.

Outstanding Investment Commitments. At September 30, 2006, we had outstanding private finance investment commitments as follows:

($ in millions)	Companies More Than 25% Owned[1]	Companies 5% to 25% Owned	Companies Less Than 5% Owned	Total
Senior loans	$ 19.6	$ 12.6	$ 93.3	$ 125.5[2]
Unitranche debt			85.8	85.8
Subordinated debt	36.6	3.1	6.8	46.5
Total loans and debt securities	56.2	15.7	185.9	257.8
Equity securities	86.7	11.7	43.3	141.7[3]
Total	$ 142.9	$ 27.4	$ 229.2	$ 399.5

(1) Includes various commitments to Callidus Capital Corporation (Callidus), which owns 80% (subject to dilution) of Callidus Capital Management, LLC, an asset management company that structures and manages collateralized debt obligations (CDOs), collateralized loan obligations (CLOs), and other related investments as follows:

($ in millions)	Committed Amount	Amount Drawn	Amount Available to be Drawn
Subordinated debt to support warehouse facilities & warehousing activities[*]	$ 36.0	$	$ 36.0
Revolving line of credit for working capital	4.0		4.0
Purchase of preferred equity in future CLO transactions	77.0		77.0
Total	$ 117.0	$	$ 117.0

(*) Callidus has a secured warehouse credit facility with a third party for up to $240 million. The facility is used primarily to finance the acquisition of loans pending securitization through a CDO or CLO. In conjunction with this warehouse credit facility, we have agreed to designate our $36 million subordinated debt commitment for Callidus to draw upon to provide first loss capital as needed to support the warehouse facility.

(2) Includes $114.3 million in the form of revolving senior debt facilities to 22 companies.

(3) Includes $55.0 million to 16 private equity and venture capital funds, including $5.9 million in co-investment commitments to Pine Creek Equity Partners, LLC.

In addition to these outstanding investment commitments at September 30, 2006, we may be required to fund additional amounts under earn-out arrangements primarily related to buyout transactions in the future if those

companies meet agreed-upon performance targets. We also had commitments to private finance portfolio companies in the form of standby letters of credit and guarantees totaling $240.5 million. See Financial Condition, Liquidity and Capital Resources.

Our largest investment at value at September 30, 2006, was in Business Loan Express, LLC (BLX) and our largest investments at value at December 31, 2005, were in Advantage Sales & Marketing, Inc. (Advantage) and BLX.

Business Loan Express, LLC. At September 30, 2006, our investment in BLX totaled $295.1 million at cost and $284.9 million at value, or 6.2% of our total assets, which included unrealized depreciation of $10.2 million. We acquired BLX in 2000.

Total interest and related portfolio income earned from the Company s investment in BLX for the nine months ended September 30, 2006 and 2005, was as follows:

($ in millions)	**2006**	**2005**
Interest income	$ 11.9	$ 10.5
Dividend income		9.0
Fees and other income	6.3	7.0
Total interest and related portfolio income	$ 18.2	$ 26.5

Interest income from BLX for the nine months ended September 30, 2006 and 2005, included interest income of $5.7 million and $5.1 million, respectively, which was paid in kind. The interest paid in kind was paid to us through the issuance of additional Class A equity interests. Accrued interest and dividends receivable at September 30, 2006, included accrued interest due from BLX totaling $1.2 million, of which $0.7 million was paid in cash in October 2006.

Net change in unrealized appreciation or depreciation included a net decrease on our investment in BLX of $67.9 million for the nine months ended September 30, 2006, and a net increase on our investment in BLX of $15.9 million for the nine months ended September 30, 2005. See Results of Operations for a discussion of the net change in unrealized appreciation or depreciation related to this investment.

BLX is a national, non-bank lender that participates in the SBA s 7(a) Guaranteed Loan Program and is licensed by the SBA as a Small Business Lending Company (SBLC). BLX is a preferred lender, as designated by the SBA, and originates, sells, and services small business loans. In addition, BLX originates conventional small business loans and small investment real estate loans. BLX has offices across the United States and is headquartered in New York, New York. Changes in the laws or regulations that govern SBLCs or the SBA 7(a) Guaranteed Loan Program or changes in government funding for this program could have a material adverse impact on BLX and, as a result, could negatively affect our financial results.

As a limited liability company, BLX s taxable income flows through directly to its members. BLX s annual taxable income generally differs from its book income for the fiscal year due to temporary and permanent differences in the recognition of income and expenses. We hold all of BLX s Class A and Class B interests, and 94.9% of the Class C interests. BLX s taxable income is first allocated to the Class A interests to the extent that dividends are paid in cash or in kind on such interests, with the remainder being allocated to the Class B and C interests. BLX may declare dividends on its Class B interests. If declared, BLX would determine the amount of such dividend considering its estimated annual taxable income allocable to such interests.

At December 31, 2005, BLX had a three-year $275.0 million revolving credit facility provided by third party lenders that was scheduled to mature in January 2007. As the controlling equity owner in BLX, we had provided an unconditional guaranty to the revolving credit facility lenders in an amount equal to 50% of the total obligations (consisting of principal, letters of credit issued under the facility, accrued interest, and other fees) of BLX under the revolving credit facility. At December 31, 2005, the principal amount of loans outstanding on the revolving credit facility was $228.2 million and letters of credit issued under the facility were $41.7 million. The total obligation guaranteed by us at December 31, 2005, was $135.4 million.

On March 17, 2006, BLX closed on a new three-year $500.0 million revolving credit facility that matures in March 2009, which replaced the existing facility. The revolving credit facility may be expanded through new or additional commitments up to $600.0 million at BLX s option. This new facility provides for a sub-facility for the issuance of letters of credit for up to an amount equal to 25% of the committed facility. We have provided an unconditional guaranty to these revolving credit facility lenders in an amount equal to 50% of the total obligations (consisting of principal, letters of credit issued under the facility, accrued interest, and other fees) of BLX under this facility. At September 30, 2006, the principal amount outstanding on the revolving credit facility was $319.9 million and letters of credit issued under the facility were $55.9 million. The total obligation guaranteed by us at September 30, 2006, was $188.1 million. This guaranty can be called by the lenders only in the event of a default under the BLX credit facility, which includes certain defaults under our revolving credit facility. BLX has determined it was in compliance with the terms of this facility at September 30, 2006.

At September 30, 2006, we had also provided four standby letters of credit totaling $29.5 million in connection with four term securitization transactions completed by BLX. In consideration for providing the revolving credit facility guaranty and the standby letters of credit, BLX paid us fees of $4.6 million and $4.7 million for the nine months ended September 30, 2006 and 2005, respectively, which were included in fees and other income above.

Advantage Sales & Marketing, Inc. At December 31, 2005, our investment in Advantage totaled $257.7 million at cost and $660.4 million at value, or 16.4% of our total assets, which included unrealized appreciation of $402.7 million. We completed the purchase of a majority ownership in Advantage in June 2004.

On March 29, 2006, we sold our majority equity interest in Advantage. We were repaid our $184 million in subordinated debt outstanding and realized a gain at closing on our equity investment sold of $433.1 million, subject to post-closing adjustments. As consideration for the common stock sold in the transaction, we received a $150 million subordinated note, with the balance of the consideration paid in cash. Approximately $34 million of our cash proceeds from the sale of the common stock were placed in escrow at closing, subject to certain holdback provisions. In the second and third quarters of 2006, we realized additional gains resulting from post-closing adjustments totaling $1.3 million. In addition, there is potential for us to receive additional consideration through an earn-out payment that would be based on Advantage s 2006 audited results. Our realized gain of $434.4 million as of September 30, 2006, subject to post-closing adjustments, excludes any earn-out amounts. For tax purposes, the receipt of the $150 million subordinated note as part of our consideration for the common stock sold will allow us, through installment treatment, to defer the recognition of taxable income for a portion of our realized gain until the note is collected. In connection with the transaction, we retained an equity investment in the business valued at $15 million at closing as a minority shareholder.

Total interest and related portfolio income earned from our investment in Advantage while we held a majority equity interest was $14.1 million, which included a prepayment premium of $5.0 million, for the nine months ended September 30, 2006, and $28.2 million for the nine months ended September 30, 2005. In addition, we earned structuring fees of $2.3 million on our new $150 million subordinated debt investment in Advantage upon the closing of the sale transaction.

Our investment in Advantage at September 30, 2006, which was composed of subordinated debt and a minority equity interest, totaled $152.9 million at cost and $163.9 million at value, which included unrealized appreciation of $11.0 million. Subsequent to the completion of the sale transaction, our interest income from our subordinated debt investment in Advantage for the three and nine months ended September 30, 2006, was $4.6 million and $9.4 million, respectively.

Advantage is a sales and marketing agency providing outsourced sales, merchandising, and marketing services to the consumer packaged goods industry. Advantage has offices across the United States and is headquartered in Irvine, CA.

Commercial Real Estate Finance

The commercial real estate finance portfolio at value, investment activity, and the yield on interest-bearing investments at and for the three and nine months ended September 30, 2006 and 2005, and at and for the year ended December 31, 2005, 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 Year Ended December 31,	
	2006		2005		2006		2005		2005	
($ in millions)	Value	Yield[1]	Value	Yield[1]	Value	Yield[1]	Value	Yield[1]	Value	Yield[1]
Portfolio at value:										
Commercial mortgage loans	$ 94.4	7.7%	121.2	6.6%	$ 94.4	7.7%	121.2	6.6%	102.6	7.6%
Real estate owned	15.3		15.1		15.3		15.1		13.9	
Equity interests	22.1		6.5		22.1		6.5		10.6	
Total portfolio	$ 131.8		$ 142.8		$ 131.8		$ 142.8		$ 127.1	
Investments funded	$ 0.3		$ 7.7		$ 14.2		$ 196.3		$ 213.5	
Change in accrued or reinvested interest	$ 0.1		$ (0.4)		$ 0.6		$ (18.5)		$ (18.0)	
Principal collections related to investment repayments or sales[2]	$ 0.7		$ 4.5		$ 17.9		$ 765.3		$ 799.5	

(1) The weighted average yield on the commercial mortgage loans is computed as the (a) annual stated interest on accruing loans plus the annual amortization of loan origination fees, original issue discount, and market discount on accruing loans less the annual amortization of origination costs, divided by (b) total interest-bearing investments at value. The weighted average yield is computed as of the balance sheet date.

(2) Principal collections related to investment repayments or sales for the year ended December 31, 2005, included $718.1 million related to the sale of our CMBS and CDO portfolio in May 2005.

Our commercial real estate investments funded for the nine months ended September 30, 2006 and 2005, and for the year ended December 31, 2005, were as follows:

($ in millions)	Face Amount	Discount	Amount Funded
For the Nine Months Ended September 30, 2006			
Commercial mortgage loans	$ 7.7	$	$ 7.7
Equity interests	6.5		6.5
Total	$ 14.2	$	$ 14.2

For the Nine Months Ended September 30, 2005			
CMBS bonds (4 new issuances)[1]	$ 211.5	$ (90.5)	$ 121.0
Commercial mortgage loans	73.5	(0.9)	72.6
Equity interests	2.7		2.7
Total	$ 287.7	$ (91.4)	$ 196.3
For the Year Ended December 31, 2005			
CMBS bonds (4 new issuances)[1]	$ 211.5	$ (90.5)	$ 121.0
Commercial mortgage loans	88.5	(0.8)	87.7
Equity interests	4.8		4.8
Total	$ 304.8	$ (91.3)	$ 213.5

(1) The CMBS bonds invested in during 2005 were sold on May 3, 2005.

At September 30, 2006, we had outstanding funding commitments related to commercial mortgage loans and equity interests of $9.1 million and commitments in the form of standby letters of credit and guarantees related to equity interests of $6.9 million.

Sale of CMBS Bonds and Collateralized Debt Obligation Bonds and Preferred Shares. On May 3, 2005, we completed the sale of our portfolio of commercial mortgage-backed securities (CMBS) and real estate related collateralized debt obligation (CDO) bonds and preferred shares to affiliates of Caisse de dépôt et placement du Québec (the Caisse) for cash proceeds of $976.0 million and a net realized gain of $227.7 million, after transaction and other costs of $7.8 million. Transaction costs included investment banking fees, legal and other professional fees, and other transaction costs. The CMBS and CDO assets sold had a cost basis at closing of $739.8 million, including accrued interest of $21.7 million. Upon the closing of the sale, we settled all the hedge positions relating to these assets, which resulted in a net realized loss of $0.7 million, which was included in the net realized gain on the sale.

Simultaneous with the sale of our CMBS and CDO portfolio, we entered into a platform assets purchase agreement with CWCapital Investments LLC, an affiliate of the Caisse (CWCapital), pursuant to which we agreed to sell certain commercial real estate related assets, including servicer advances, intellectual property, software and other platform assets, subject to certain adjustments. Under this agreement, we have agreed not to invest in CMBS and real estate-related CDOs and refrain from certain other real estate-related investing or servicing activities for a period of three years, or through May 2008, subject to certain limitations and excluding our existing portfolio and related activities.

The real estate securities purchase agreement, under which we sold the CMBS and CDO portfolio, and the platform asset purchase agreement contain customary representations and warranties, and require us to indemnify the affiliates of the Caisse that are parties to the agreements for certain liabilities arising under the agreements, subject to certain limitations and conditions.

Hedging Activities

We have invested in commercial mortgage loans, which were purchased at prices that were based in part on comparable Treasury rates. We have entered into transactions with one or more financial institutions to hedge against movement in Treasury rates on certain of these commercial mortgage loans. These transactions, referred to as short sales, involve receiving the proceeds from the short sales of borrowed Treasury securities, with the obligation to replenish the borrowed Treasury securities at a later date based on the then current market price, whatever that price may be. Risks in these contracts arise from movements in the value of the borrowed Treasury securities due to changes in interest rates and from the possible inability of counterparties to meet the terms of their contracts. If the value of the borrowed Treasury securities increases, we will incur losses on these transactions. These losses are limited to the increase in value of the borrowed Treasury securities; conversely, the value of the hedged commercial mortgage loans would likely increase. If the value of the borrowed Treasury securities decreases, we will incur gains on these transactions which are limited to the decline in value of the borrowed Treasury securities; conversely, the value of the hedged commercial mortgage loans would likely decrease. We do not anticipate nonperformance by any counterparty in connection with these transactions.

The total obligations to replenish borrowed Treasury securities, including accrued interest payable on the obligations, were $17.7 million at both September 30, 2006, and December 31, 2005. The net proceeds related to the sales of the borrowed Treasury securities plus or minus the additional cash collateral provided or received under the terms of the transactions were $17.7 million at both September 30, 2006, and December 31, 2005. The amount of the hedge will vary from period to period depending upon the amount of commercial mortgage loans that we own and have hedged as of the balance sheet date.

PORTFOLIO ASSET QUALITY

Portfolio by Grade. We employ a grading system for our 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 investment return or principal is expected. Grade 4 is used for investments that are in workout and for which some loss of current

investment return is expected, but no loss of principal is expected. Grade 5 is used for investments that are in workout and for which some loss of principal is expected.

At September 30, 2006, and December 31, 2005, our portfolio was graded as follows:

	2006		2005	
Grade ($ in millions)	Portfolio at Value	Percentage of Total Portfolio	Portfolio at Value	Percentage of Total Portfolio
1	$ 1,082.1	26.3%	$ 1,643.0	45.6%
2	2,767.1	67.2	1,730.8	48.0
3	153.4	3.7	149.1	4.1
4	57.9	1.4	26.5	0.7
5	59.1	1.4	57.0	1.6
	$ 4,119.6	100.0%	$ 3,606.4	100.0%

The amount of the portfolio in each grading category may vary substantially from period to period resulting primarily from changes in the composition of the portfolio as a result of new investment, repayment, and exit activity, changes in the grade of investments to reflect our expectation of performance, and changes in investment values.

Total Grade 4 and 5 portfolio assets were $117.0 million and $83.5 million, respectively, or were 2.8% and 2.3%, respectively, of the total portfolio at value at September 30, 2006, and December 31, 2005. Grade 4 and 5 assets include loans, debt securities, and equity securities. We expect that a number of investments will be in the Grades 4 or 5 categories from time to time. Part of the private equity business is working with troubled portfolio companies to improve their businesses and protect our investment. The number and amount of investments included in Grade 4 and 5 may fluctuate from period to period. We continue to follow our historical practice of working with portfolio companies in order to recover the maximum amount of our investment.

Loans and Debt Securities on Non-Accrual Status. At September 30, 2006, and December 31, 2005, loans and debt securities at value not accruing interest for the total investment portfolio were as follows:

($ in millions)	2006	2005
Loans and debt securities in workout status (classified as Grade 4 or 5)[1]		
Private finance		
Companies more than 25% owned	$ 52.3	$ 15.6
Companies 5% to 25% owned	2.7	
Companies less than 5% owned	24.8	11.4
Commercial real estate finance	6.7	12.9
Loans and debt securities not in workout status		
Private finance		
Companies more than 25% owned	36.0	58.0
Companies 5% to 25% owned	7.2	0.5

Companies less than 5% owned	18.3	49.5
Commercial real estate finance	13.7	7.9
Total	$ 161.7	$ 155.8
Percentage of total portfolio	3.9%	4.3%

(1) Workout loans and debt securities exclude equity securities that are included in the total Grade 4 and 5 assets above.

Loans and Debt Securities Over 90 Days Delinquent. Loans and debt securities greater than 90 days delinquent at value at September 30, 2006, and December 31, 2005, were as follows:

($ in millions)	**2006**	**2005**
Private finance	$ 41.2	$ 74.6
Commercial mortgage loans	3.7	6.1
Total	$ 44.9	$ 80.7
Percentage of total portfolio	1.1%	2.2%

In general, interest is not accrued on loans and debt securities if we have doubt about interest collection or where the enterprise value of the portfolio company may not support further accrual. In addition, interest may not accrue on loans to portfolio companies that are more than 50% owned by us depending on such company s capital requirements. To the extent interest payments are received on a loan that is not accruing interest, we may use such payments to reduce our cost basis in the investment in lieu of recognizing interest income.

As a result of these and other factors, the amount of the portfolio that is greater than 90 days delinquent or on non-accrual status may vary from period to period. Loans and debt securities on non-accrual status and over 90 days delinquent should not be added together as they are two separate measures of portfolio asset quality. Loans and debt securities that are in both categories (i.e., on non-accrual status and over 90 days delinquent) totaled $44.9 million and $60.7 million at September 30, 2006, and December 31, 2005, respectively.

PORTFOLIO RETURNS

Since our merger on December 31, 1997, through September 30, 2006, our combined aggregate cash flow Internal Rate of Return (IRR) has been approximately 22% for private finance and CMBS/CDO investments exited during this period. The IRR is calculated using the aggregate portfolio cash flow for all investments exited over this period. For investments exited during this period, we invested capital totaling $3.8 billion. The weighted average holding period of these investments was 35 months. Investments are considered to be exited when the original investment objective has been achieved through the receipt of cash and/or non-cash consideration upon the repayment of our debt investment or sale of an equity investment, or through the determination that no further consideration was collectible and, thus, a loss may have been realized. The aggregate cash flow IRR for private finance investments was approximately 21% and for CMBS/CDO investments was approximately 24% for the same period. The weighted average holding period of the private finance and CMBS/CDO investments was 48 months and 22 months, respectively, for the same period. These IRR results represent historical results. Historical results are not necessarily indicative of future results.

OTHER ASSETS AND OTHER LIABILITIES

Other assets is composed primarily of fixed assets, assets held in deferred compensation trusts, deferred financing and offering costs, and accounts receivable, which includes amounts received in connection with the sale of portfolio companies, including amounts held in escrow, and other receivables from portfolio companies. At September 30, 2006, and December 31, 2005, other assets totaled $119.5 million and $87.9 million, respectively. The increase since year end was primarily the result of amounts received in connection with the sales of Advantage and STS Operating, Inc., that are being held in escrow. See Results of Operations below.

Accounts payable and other liabilities is primarily composed of the liabilities related to the deferred compensation trust and accrued interest, bonus and taxes, including excise tax. At September 30, 2006, and December 31, 2005, accounts payable and other liabilities totaled $133.1 million and $102.9 million, respectively. The increase since year end was primarily the result of an increase in accrued interest payable by $22.2 million. Accrued interest fluctuates from period to period depending on the amount of debt outstanding and the contractual payment dates of the interest on such debt. Interest on our debt is primarily due on a semi-annual basis, which results in fluctuations of the quarter-end liability.

RESULTS OF OPERATIONS

Comparison of Three and Nine Months Ended September 30, 2006 and 2005

The following table summarizes the Company s operating results for the three and nine months ended September 30, 2006 and 2005.

	For the Three Months Ended September 30,				For the Nine Months Ended September 30,			Pe
sands, except per share amounts)	**2006**	**2005**	**Change**	**Percentage Change**	**2006**	**2005**	**Change**	
	(unaudited)				**(unaudited)**			
nd Related Portfolio Income								
d dividends	$ 98,668	$ 76,353	$ 22,315	29%	$ 282,982	$ 232,628	$ 50,354	
ther income	14,715	18,504	(3,789)	(20)%	51,868	43,355	8,513	
est and related portfolio income	113,383	94,857	18,526	20%	334,850	275,983	58,867	
	26,109	17,929	8,180	46%	72,455	57,483	14,972	
	25,228	13,969	11,259	81%	67,054	52,302	14,752	
stock options	3,649		3,649	100%	11,852		11,852	
ative	8,153	14,936	(6,783)	(45)%	29,348	58,563	(29,215)	
ating expenses	63,139	46,834	16,305	35%	180,709	168,348	12,361	
ment income before income taxes	50,244	48,023	2,221	5%	154,141	107,635	46,506	
expense (benefit), including excise	1,586	1,889	(303)	(16)%	13,988	7,482	6,506	
ment income	48,658	46,134	2,524	5%	140,153	100,153	40,000	
zed and Unrealized Gains (Losses)								
d gains	9,916	70,714	(60,798)	*	542,991	288,495	254,496	
e in unrealized appreciation or on	19,312	(3,680)	22,992	*	(471,942)	156,026	(627,968)	
ains	29,228	67,034	(37,806)	*	71,049	444,521	(373,472)	
e	$ 77,886	$ 113,168	$ (35,282)	(31)%	$ 211,202	$ 544,674	$ (333,472)	
rnings per common share	$ 0.53	$ 0.82	$ (0.29)	(35)%	$ 1.47	$ 3.99	$ (2.52)	
average common shares outstanding	147,112	138,058	9,054	7%	144,030	136,669	7,361	

* Net realized gains (losses) and net change in unrealized appreciation or depreciation can fluctuate significantly from period to period. As a result, comparisons may not be meaningful.

Total Interest and Related Portfolio Income. Total interest and related portfolio income includes interest and dividend income, loan prepayment premiums, and fees and other income.

Interest and Dividends. Interest and dividend income for the three and nine months ended September 30, 2006 and 2005, was composed of the following:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
($ in millions)	**2006**	**2005**	**2006**	**2005**
Interest				
Private finance loans and debt securities	$ 90.9	$ 67.4	$ 262.1	$ 177.2
CMBS and CDO portfolio				29.4
Commercial mortgage loans	1.7	1.7	6.5	5.2
Cash and cash equivalents, U.S. Treasury bills and other	5.0	2.0	10.9	6.1
Total interest	97.6	71.1	279.5	217.9
Dividends	1.1	5.3	3.5	14.7
Total interest and dividends	$ 98.7	$ 76.4	$ 283.0	$ 232.6

Our interest income from our private finance loans and debt securities has increased period over period as a result of the growth in this portfolio as shown below.

There was no interest income from the CMBS and real estate-related CDO portfolio in 2006 as we sold this portfolio on May 3, 2005. The CMBS and CDO portfolio sold had a cost basis of $718.1 million and a weighted average yield on the cost basis of the portfolio of approximately 13.8%. We generally reinvested the principal proceeds from the CMBS and CDO portfolio into our private finance portfolio.

The level of portfolio-related interest income, which includes interest paid in cash and in kind, is directly related to the balance of the interest-bearing investment portfolio outstanding during the period multiplied by the weighted average yield. The interest-bearing investments in the portfolio at value and the yield on the interest-bearing investments in the portfolio at September 30, 2006 and 2005, were as follows:

	2006		2005	
($ in millions)	**Value**	**Yield[(1)]**	**Value**	**Yield[(1)]**
Private finance loans and debt securities	$ 2,905.2	12.5%	$ 2,039.6	13.0%
Commercial mortgage loans	94.4	7.7%	121.2	6.6%
Total	$ 2,999.6	12.3%	$ 2,160.8	12.6%

(1) The weighted average yield on loans and debt securities is computed as the (a) annual stated interest on accruing loans and debt securities plus the annual amortization of loan origination fees, original issue discount, and market

discount on accruing loans and debt securities less the annual amortization of loan origination costs, divided by (b) total loans and debt securities at value. The weighted average yield is computed as of the balance sheet date.

The private finance portfolio yield at September 30, 2006, of 12.5% as compared to the private finance portfolio yield of 13.0% at September 30, 2005, reflects the mix of debt investments in the private finance portfolio. The weighted average yield varies from period to period based on the current stated interest on interest-bearing investments and the amount of loans and debt securities for which interest is not accruing. See the discussion of the private finance portfolio yield above under the caption Portfolio and Investment Activity Private Finance.

Dividend income results from the dividend yield on preferred equity interests, if any, or the declaration of dividends by a portfolio company on preferred or common equity interests. Dividend income will vary from period to period depending upon the timing and amount of dividends that are declared or paid by a portfolio company

on preferred or common equity interests. Dividend income for the three and nine months ended September 30, 2006, did not include any dividends from BLX. Dividend income for the three and nine months ended September 30, 2005, included $4.0 million and $9.0 million, respectively, of dividends from BLX on the Class B equity interests held by us, which were paid in cash. See the discussion of BLX above under the caption Portfolio and Investment Activity Private Finance.

Fees and Other Income. Fees and other income primarily include fees related to financial structuring, diligence, transaction services, management and consulting services to portfolio companies, commitments, guarantees, and other services and loan prepayment premiums. As a business development company, we are required to make significant managerial assistance available to the companies in our investment portfolio. Managerial assistance includes, but is not limited to, management and consulting services related to corporate finance, marketing, human resources, personnel and board member recruiting, business operations, corporate governance, risk management and other general business matters.

Fees and other income for the three and nine months ended September 30, 2006 and 2005, included fees and other income relating to the following:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
($ in millions)	**2006**	**2005**	**2006**	**2005**
Structuring and diligence	$ 9.3	$ 10.2	$ 28.4	$ 19.1
Management, consulting and other services provided to portfolio companies	2.6	4.0	9.1	10.8
Commitment, guaranty, transaction and other fees from portfolio companies	2.1	1.7	6.7	6.5
Loan prepayment premiums	0.7	2.1	7.7	4.6
Other income		0.5		2.4
Total fees and other income	$ 14.7	$ 18.5	$ 51.9	$ 43.4

Fees and other income are generally related to specific transactions or services and therefore may vary substantially from period to period depending on the level of investment activity and types of services provided. Loan origination fees that represent yield enhancement on a loan are capitalized and amortized into interest income over the life of the loan.

Structuring and diligence fees for the nine months ended September 30, 2006 and 2005, included structuring fees from both companies more than 25% owned and 5% to 25% owned totaling $10.1 million and $6.8 million, respectively. Structuring and diligence fees from companies 5% to 25% owned for the nine months ended September 30, 2006, included a structuring fee from Advantage Sales and Marketing totaling $2.3 million. Structuring and diligence fees may vary substantially from period to period based on the level of new investment originations and the market rates for these types of fees. Private finance investments funded were $1.9 billion for the nine months ended September 30, 2006, as compared to $1.1 billion for the nine months ended September 30, 2005.

Management fees for the nine months ended September 30, 2006, included $1.8 million in management fees from Advantage prior to its sale on March 29, 2006. See Portfolio and Investment Activity above for further discussion.

Management fees for the three and nine months ended September 30, 2005, included $1.8 million and $4.9 million, respectively, in management fees from Advantage.

Fees and other income related to the CMBS and CDO portfolio for the nine months ended September 30, 2005, were $4.1 million. As noted above, we sold our CMBS and CDO portfolio on May 3, 2005.

Loan prepayment premiums for the nine months ended September 30, 2006, included $5.0 million related to the repayment of our subordinated debt in connection with the sale of our majority equity interest in Advantage on March 29, 2006. See Portfolio and Investment Activity above for further discussion. While the scheduled maturities of private finance and commercial real estate loans generally range from five to ten years, it is not unusual for our borrowers to refinance or pay off their debts to us ahead of schedule. Therefore, we generally structure our loans to require a prepayment premium for the first three to five years of the loan. Accordingly, the amount of prepayment premiums will vary depending on the level of repayments and the age of the loans at the time of repayment.

BLX and Advantage. BLX was our largest investment at value at September 30, 2006, and represented 6.2% of our total assets. Advantage and BLX were our largest investments at September 30, 2005, and together represented 22.9% of our total assets.

Total interest and related portfolio income from these investments for the three and nine months ended September 30, 2006 and 2005, was as follows:

($ in millions)	For the Three Months Ended September 30, 2006	2005	For the Nine Months Ended September 30, 2006	2005
BLX	$ 6.1	$ 9.9	$ 18.2	$ 26.5
Advantage[(1)]	$	$ 9.6	$ 14.1	$ 28.2

(1) Includes income from the period we held a majority equity interest only. See Portfolio and Investment Activity above for further discussion.

See Portfolio and Investment Activity above for further detail on BLX and Advantage.

Operating Expenses. Operating expenses include interest, employee, employee stock options, and administrative expenses.

Interest Expense. The fluctuations in interest expense during the three and nine months ended September 30, 2006 and 2005, were primarily attributable to changes in the level of our borrowings under various notes payable and debentures and our revolving line of credit. Our borrowing activity and weighted average cost of debt, including fees and debt financing costs, at and for the three and nine months ended September 30, 2006 and 2005, were as follows:

($ in millions)	At and for the Three Months Ended September 30, 2006	2005	At and for the Nine Months Ended September 30, 2006	2005
Total outstanding debt	$ 1,590.7	$ 968.3	$ 1,590.7	$ 968.3
Average outstanding debt	$ 1,507.5	$ 980.8	$ 1,433.5	$ 1,058.4
Weighted average cost[(1)]	6.6%	6.8%	6.6%	6.8%

(1) The weighted average annual interest cost is computed as the (a) annual stated interest rate on the debt plus the annual amortization of commitment fees, other facility fees and debt financing costs that are recognized into interest expense over the contractual life of the respective borrowings, divided by (b) debt outstanding on the balance sheet date.

In addition, interest expense included interest paid to the Internal Revenue Service related to installment sale gains totaling $0.3 million and $0.2 million for the three months ended September 30, 2006 and 2005, respectively, and $0.7 million and $0.4 million for the nine months ended September 30, 2006 and 2005, respectively. See Financial Condition, Liquidity and Capital Resources below.

Interest expense also included interest on our obligations to replenish borrowed Treasury securities related to our hedging activities of $0.2 million for both the three months ended September 30, 2006 and 2005, and $0.5 million and $1.3 million for the nine months ended September 30, 2006 and 2005, respectively.

Employee Expense. Employee expenses for the three and nine months ended September 30, 2006 and 2005, were as follows:

($ in millions)	For the Three Months Ended September 30, 2006	For the Three Months Ended September 30, 2005	For the Nine Months Ended September 30, 2006	For the Nine Months Ended September 30, 2005
Salaries and employee benefits	$ 19.6	$ 11.0	$ 54.6	$ 34.5
Transition compensation, net		(0.1)		5.4
Individual performance award (IPA)	2.1	1.7	6.0	5.5
IPA mark to market expense (benefit)	1.2	(0.4)	0.6	1.5
Individual performance bonus (IPB)	2.3	1.8	5.9	5.4
Total employee expense	$ 25.2	$ 14.0	$ 67.1	$ 52.3
Number of employees at end of period	168	127	168	127

The change in salaries and employee benefits reflects the effect of an increase in the number of employees, compensation increases and the change in mix of employees given their area of responsibility and relevant experience level. Salaries and employee benefits include an accrual for employee bonuses, which are generally paid annually after the completion of the fiscal year. The quarterly accrual is based upon an estimate of annual bonuses and is subject to change. The amount of the current year bonuses will be finalized by the Compensation Committee and the Board of Directors at the end of the year. Salaries and employee benefits include accrued bonuses of $10.7 million and $3.6 million for the three months ended September 30, 2006 and 2005, respectively, and $27.6 million and $10.8 million for the nine months ended September 30, 2006 and 2005, respectively.

At September 30, 2006, and December 31, 2005, the total accrued bonus was $27.6 million and $26.9 million, respectively, and was included in Accounts Payable and Other Liabilities on the accompanying Balance Sheet.

Transition compensation costs were $6.5 million for the nine months ended September 30, 2005, including $3.4 million of costs under retention agreements and $3.1 million of transition services bonuses awarded to certain employees in the commercial real estate group as a result of the sale of the CMBS and CDO portfolio. Transition compensation expenses were reduced by $1.1 million for salary reimbursements from CWCapital under the transition services agreement, resulting in net expense related to the sale of the CMBS and CDO portfolio of $5.4 million. See the caption Portfolio and Investment Activity Commercial Real Estate Finance for additional information.

The Individual Performance Award (IPA) is a long-term incentive compensation program for certain officers. The IPA, which is generally determined annually at the beginning of each year, is deposited into a deferred compensation trust generally in four equal installments, on a quarterly basis, in the form of cash. The accounts of the trust are consolidated with our accounts. We are required to mark to market the liability of the trust and this adjustment is recorded to the IPA compensation expense. Because the IPA is deferred compensation, the cost of this award is not a current expense for purposes of computing our taxable income. The expense is deferred for tax purposes until distributions are made from the trust.

As a result of changes in regulation by the Jobs Creation Act of 2004 associated with deferred compensation arrangements, as well as an increase in the competitive market for recruiting talent in the private equity industry, the Compensation Committee and the Board of Directors determined that for 2005 and 2006 a portion of the IPA should

be replaced with an individual performance bonus (IPB). The IPB is distributed in cash to award recipients in equal bi-weekly installments (beginning in February of each respective year) as long as the recipient remains employed by us.

The Compensation Committee and the Board of Directors have determined the IPA and the IPB for 2006. We currently estimate the IPA and IPB to be approximately $8.1 million each; however, the Compensation Committee may adjust the IPA or IPB as needed, or make new awards as new officers are hired. If a recipient

terminates employment during the year, any further cash contribution for the IPA or remaining cash payments under the IPB would be forfeited.

In connection with our 2006 Annual Meeting of Stockholders, the stockholders approved the issuance of up to 2.5 million shares of our common stock in exchange for the cancellation of vested in-the-money stock options granted to certain officers and directors under our Amended Stock Option Plan. Under the initiative, which has been reviewed and approved by our Board of Directors, all optionees who hold vested stock options with exercise prices below the market value of the stock (or in-the-money options), would be offered the opportunity to receive an Option Cancellation Payment (OCP) equal to the in-the-money value of the stock options cancelled, which would be paid one-half in cash and one-half in shares of our common stock, in exchange for their voluntary cancellation of their vested stock options. As part of this initiative, the Board of Directors has adopted a target ownership structure that establishes minimum ownership levels for our senior officers and continues to further align the interests of our officers with those of our stockholders.

Unlike the accounting treatment typically associated with a stock option exercise, the OCP would be recorded as an expense for financial reporting purposes, and the expense may be significant. Based on the 13 million vested options outstanding and the market price of $30.50 of our stock on March 10, 2006, the date used for disclosure in our 2006 proxy, the expense related to the OCP would be approximately $106 million if all option holders choose to cancel all vested in-the-money options in exchange for the OCP. As of September 30, 2006, there were 17 million vested options outstanding, which were all in-the-money. Using the market price of $30.21 of our stock on September 30, 2006, the expense related to the OCP would be approximately $109 million if all option holders chose to cancel all vested in-the-money options in exchange for the OCP. For income tax purposes, our tax expense resulting from the OCP would be similar to the tax expense that would result from an exercise of stock options in the market. Any tax deduction for us resulting from the OCP or an exercise of stock options in the market would be limited by Section 162(m) of the Code for persons subject to Section 162(m).

Stock Options Expense. In December 2004, the FASB issued Statement No. 123 (Revised 2004), *Share-Based Payment* (the Statement), which requires companies to recognize the grant-date fair value of stock options and other equity-based compensation issued to employees in the income statement. The Statement was effective January 1, 2006, and it applies to our stock option plan. Our employee stock options are typically granted with ratable vesting provisions, and we amortize the compensation cost over the related service period. With respect to options granted prior to January 1, 2006, we have used the modified prospective method for adoption of the Statement. Under this method, the unamortized cost of previously awarded options that were unvested as of January 1, 2006, is recognized over the remaining service period in the statement of operations beginning in 2006. With respect to options granted on or after January 1, 2006, compensation cost is recognized in the statement of operations over the service period. The effect of this adoption for the three and nine months ended September 30, 2006, was as follows:

($ in millions)	**For the Three Months Ended September 30, 2006**	**For the Nine Months Ended September 30, 2006**
Employee Stock Option Expense:		
Previously awarded, unvested options as of January 1, 2006	$ 3.2	$ 9.9
Options granted on or after January 1, 2006	0.4	2.0
Total employee stock option expense	$ 3.6	$ 11.9

In addition to the employee stock option expense, for the three and nine months ended September 30, 2006, administrative expense included zero and $0.2 million of expense related to options granted to directors during the period. Options granted to non-officer directors vest on the grant date and therefore, the full expense is recorded on the grant date.

We estimate that the employee-related stock option expense under the Statement that will be recorded in our statement of operations will be approximately $16.2 million, $10.5 million, and $3.4 million for the years ended December 31, 2006, 2007, and 2008, respectively, which includes approximately $2.7 million, $1.7 million, and $0.9 million, respectively, related to options granted in the nine months ended September 30, 2006. This estimate may change if our assumptions related to future option forfeitures change. This estimate does not include any expense related to future stock option grants as the fair value of those stock options will be determined at the time of grant.

Administrative Expense. Administrative expenses include legal and accounting fees, valuation assistance fees, insurance premiums, the cost of leases for our headquarters in Washington, DC, and our regional offices, portfolio origination and development expenses, travel costs, stock record expenses, directors fees and stock options expense, and various other expenses. Administrative expenses for the three and nine months ended September 30, 2006 and 2005, were as follows:

($ in millions)	For the Three Months Ending September 30, 2006	2005	For the Nine Months Ending September 30, 2006	2005
Administrative expenses	$ 7.6	$ 8.0	$ 25.3	$ 25.9
Investigation related costs	0.6	6.9	4.0	32.7
Total administrative expenses	$ 8.2	$ 14.9	$ 29.3	$ 58.6

Investigation related costs include costs associated with requests for information in connection with two government investigations. These expenses remain difficult to predict. See Note 14 in the accompanying financial statements.

Income Tax Expense (Benefit), Including Excise Tax. Income tax expense (benefit) for the three and nine months ended September 30, 2006 and 2005, was as follows:

($ in millions)	For the Three Months Ended September 30, 2006	2005	For the Nine Months Ended September 30, 2006	2005
Income tax expense (benefit), net	$ (0.6)	$ 0.6	$ 0.2	$ 2.2
Excise tax expense[1]	2.2	1.3	13.8	5.3
Income tax expense (benefit), including excise tax	$ 1.6	$ 1.9	$ 14.0	$ 7.5

[1] Includes an accrual for the 2006 estimated excise tax of $2.5 million and $14.1 million for the three and nine months ended September 30, 2006, respectively, net of the reversal of over accrued excise taxes related to 2005 of $0.3 million for both the three and nine months ended September 30, 2006.

Our wholly owned subsidiary, A.C. Corporation, is a corporation subject to federal and state income taxes and records a benefit or expense for income taxes as appropriate based on its operating results in a given period. In addition, our estimated annual taxable income for 2006 currently exceeds our estimated dividend distributions to shareholders from

such taxable income in 2006, and such estimated excess taxable income will be distributed in 2007. Therefore, we will be required to pay a 4% excise tax on the excess of 98% of our taxable income over the amount of actual distributions from such taxable income. Accordingly, we have accrued an estimated excise tax of $2.5 million and $14.1 million for the three and nine months ended September 30, 2006, respectively, based upon our estimated excess taxable income earned for the 2006 period. See Financial Condition, Liquidity and Capital Resources. While excise tax expense is presented in the Consolidated Statement of Operations as a reduction to net investment income, excise tax relates to both net investment income and net realized gains. At September 30, 2006, and December 31, 2005, excise tax payable was $14.1 million and $6.2 million, respectively, which was included in accounts payable and other liabilities on the accompanying Balance Sheet.

Realized Gains and Losses. Net realized gains primarily result from the sale of equity securities associated with certain private finance investments, the sale of CMBS bonds and CDO bonds and preferred shares, and the realization of unamortized discount resulting from the sale and early repayment of private finance loans and commercial mortgage loans, offset by losses on investments. Net realized gains for the three and nine months ended September 30, 2006 and 2005, were as follows:

($ in millions)	For the Three Months Ended September 30, 2006	For the Three Months Ended September 30, 2005	For the Nine Months Ended September 30, 2006	For the Nine Months Ended September 30, 2005
Realized gains	$ 12.6	$ 79.8	$ 550.1	$ 339.2
Realized losses	(2.7)	(9.1)	(7.1)	(50.7)
Net realized gains	$ 9.9	$ 70.7	$ 543.0	$ 288.5

When we exit an investment and realize a gain or loss, we make an accounting entry to reverse any unrealized appreciation or depreciation, respectively, we had previously recorded to reflect the appreciated or depreciated value of the investment. For the three and nine months ended September 30, 2006 and 2005, we reversed previously recorded unrealized appreciation or depreciation when gains or losses were realized as follows:

($ in millions)	For the Three Months Ended September 30, 2006	For the Three Months Ended September 30, 2005	For the Nine Months Ended September 30, 2006	For the Nine Months Ended September 30, 2005
Reversal of previously recorded unrealized appreciation associated with realized gains	$ (10.2)	$ (80.5)	$ (499.4)	$ (107.0)
Reversal of previously recorded unrealized depreciation associated with realized losses	2.2	7.4	5.4	49.3
Total reversal	$ (8.0)	$ (73.1)	$ (494.0)	$ (57.7)

Realized gains for the three months ended September 30, 2006 and 2005, were as follows:

($ in millions)

2006 Portfolio Company	Amount
Private Finance:	
Oriental Trading Company, Inc.	$ 8.9
Component Hardware Group, Inc.	2.8
Advantage Sales & Marketing, Inc.	0.7

Other		0.2
Total private finance		12.6
Total gross realized gains	$	12.6

2005 Portfolio Company		**Amount**
Private Finance:		
Housecall Medical Resources, Inc.	$	52.0
Fairchild Industrial Products Company		16.2
Apogen Technologies, Inc.		9.0
Other		0.8
Total private finance		78.0
Commercial Real Estate:		
Other		1.8
Total commercial real estate		1.8
Total gross realized gains	$	79.8

Realized losses for the three months ended September 30, 2006 and 2005, were as follows:

($ in millions)

2006 Portfolio Company	Amount
Private Finance:	
Cooper Natural Resources, Inc.	$ 2.2
Other	0.5
Total private finance	2.7
Total gross realized losses	$ 2.7

2005 Portfolio Company	Amount
Private Finance:	
HealthASPex, Inc.	$ 3.5
MortgageRamp, Inc.	3.5
Other	2.1
Total private finance	9.1
Total gross realized losses	$ 9.1

Realized gains for the nine months ended September 30, 2006 and 2005, were as follows:

($ in millions)

2006 Portfolio Company	Amount
Private Finance:	
Advantage Sales & Marketing, Inc.	$ 434.4
STS Operating, Inc.	94.8
Oriental Trading Company, Inc.	8.9
United Site Services, Inc.	3.3
Component Hardware Group, Inc.	2.8
Nobel Learning Communities, Inc.	1.5
MHF Logistical Solutions, Inc.	1.2
The Debt Exchange, Inc.	1.1
Other	1.5
Total private finance	549.5

Commercial Real Estate:		
Other		0.6
Total commercial real estate		0.6
Total gross realized gains	$	550.1

2005 Portfolio Company		Amount
Private Finance:		
Housecall Medical Resources, Inc.	$	52.0
Fairchild Industrial Products Company		16.2
Apogen Technologies, Inc.		9.0
Polaris Pool Systems, Inc.		7.4
MasterPlan, Inc.		3.7
U.S. Security Holdings, Inc.		3.3
Ginsey Industries, Inc.		2.8
E-Talk Corporation		1.6
Professional Paint, Inc.		1.0
Oriental Trading Company, Inc.		1.0
Other		4.2
Total private finance		102.2
Commercial Real Estate:		
CMBS/CDO assets, net[1]		227.7
Other		9.3
Total commercial real estate		237.0
Total gross realized gains	$	339.2

(1) Net of net realized losses from related hedges of $0.7 million for the nine months ended September 30, 2005.

STS Operating, Inc. In the second quarter of 2006, we completed the sale of STS Operating, Inc. (STS). We were repaid our $6.8 million in subordinated debt outstanding and we realized a gain on the sale of our common stock in STS of $94.8 million, subject to post-closing adjustments. The cost basis of our equity was $3.5 million. As part of the consideration for the sale of our equity investment, we received a $30 million subordinated note. Approximately $11.2 million of our proceeds are subject to certain holdback provisions and post-closing adjustments. For tax purposes, the receipt of the $30 million subordinated note as part of our consideration for the common stock sold will allow us, through installment treatment, to defer the recognition of taxable income for a portion of our realized gain until the note is collected.

Realized losses for the nine months ended September 30, 2006 and 2005, were as follows:

($ in millions)

2006 Portfolio Company		Amount
Private Finance:		
Cooper Natural Resources, Inc.	$	2.2
Aspen Pet Products, Inc.		1.6
Nobel Learning Communities, Inc.		1.4
Other		1.0
Total private finance		6.2
Commercial Real Estate:		
Other		0.9
Total commercial real estate		0.9
Total gross realized losses	$	7.1

2005 Portfolio Company		Amount
Private Finance:		
Norstan Apparel Shops, Inc.	$	18.5
E-Talk Corporation		9.0
Garden Ridge Corporation		7.1
MortgageRamp, Inc.		3.5
HealthASPex, Inc.		3.5
Other		3.5
Total private finance		45.1
Commercial Real Estate:		
Other		5.6
Total commercial real estate		5.6
Total gross realized losses	$	50.7

Change in Unrealized Appreciation or Depreciation. We determine the value of each investment in our portfolio on a quarterly basis, and changes in value result in unrealized appreciation or depreciation being recognized in our statement of operations. Value, as defined in Section 2(a)(41) of the Investment Company Act of 1940, is (i) the market price for those securities for which a market quotation is readily available and (ii) for all other securities and assets, fair value is as determined in good faith by the Board of Directors. Since there is typically no readily available

market value for the investments in our portfolio, we value substantially all of our portfolio investments at fair value as determined in good faith by the Board of Directors pursuant to our valuation policy and a consistently applied valuation process. At September 30, 2006, portfolio investments recorded at fair value were approximately 90% of our total assets. Because of the inherent uncertainty of determining the fair value of investments that do not have a readily available market value, the fair value of our investments determined in good faith by the Board of Directors may differ significantly from the values that would have been used had a ready market existed for the investments, and the differences could be material.

There is no single standard for determining fair value in good faith. As a result, determining fair value requires that judgment be applied to the specific facts and circumstances of each portfolio investment while employing a consistently applied valuation process for the types of investments we make. Unlike banks, we are not permitted to provide a general reserve for anticipated loan losses. Instead, we are required to specifically value each individual investment on a quarterly basis. We will record unrealized depreciation on investments when we believe that an investment has become impaired, including where collection of a loan or realization of an equity security is doubtful, or when the enterprise value of the portfolio company does not currently support the cost of our debt or equity investment. Enterprise value means the entire value of the company to a potential buyer, including the sum of the values of debt and equity securities used to capitalize the enterprise at a point in time. We will record unrealized appreciation if we believe that the underlying portfolio company has appreciated in value and/or our equity security has also appreciated in value. Changes in fair value are recorded in the statement of operations as net change in unrealized appreciation or depreciation.

As a business development company, we have invested in illiquid securities including debt and equity securities of companies. The structure of each debt and equity security is specifically negotiated to enable us to protect our investment and maximize our returns. We include many terms governing interest rate, repayment terms, prepayment penalties, financial covenants, operating covenants, ownership parameters, dilution parameters, liquidation preferences, voting rights, and put or call rights. Our investments may be subject to certain restrictions on resale and generally have no established trading market. Because of the type of investments that we make and the nature of our business, our valuation process requires an analysis of various factors. Our fair value methodology includes the examination of, among other things, the underlying investment performance, financial condition, and market changing events that impact valuation.

Valuation Methodology Private Finance. Our process for determining the fair value of a private finance investment begins with determining the enterprise value of the portfolio company. The fair value of our investment is based on the enterprise value at which the portfolio company could be sold in an orderly disposition over a reasonable period of time between willing parties other than in a forced or liquidation sale. The liquidity event whereby we exit a private finance investment is generally the sale, the recapitalization or, in some cases, the initial public offering of the portfolio company.

There is no one methodology to determine enterprise value and, in fact, for any one portfolio company, enterprise value is best expressed as a range of fair values. We derive a single estimate of enterprise value. To determine the enterprise value of a portfolio company, we analyze its historical and projected financial results. We generally require portfolio companies to provide annual audited and quarterly unaudited financial statements, as well as annual projections for the upcoming fiscal year. Typically in the private equity business, companies are bought and sold based on multiples of EBITDA, cash flow, net income, revenues or, in limited instances, book value. The private equity industry uses financial measures such as EBITDA or EBITDAM (Earnings Before Interest, Taxes, Depreciation, Amortization and, in some instances, Management fees) in order to assess a portfolio company s financial performance and to value a portfolio company. EBITDA and EBITDAM are not intended to represent cash flow from operations as defined by U.S. generally accepted accounting principles and such information should not be considered as an alternative to net income, cash flow from operations, or any other measure of performance prescribed by U.S. generally accepted accounting principles. When using EBITDA to determine enterprise value, we may adjust EBITDA for non-recurring items. Such adjustments are intended to normalize EBITDA to reflect the portfolio company s earnings power. Adjustments to EBITDA may include compensation to previous owners, acquisition, recapitalization, or restructuring related items or one-time non-recurring income or expense items.

In determining a multiple to use for valuation purposes, we generally look to private merger and acquisition statistics, discounted public trading multiples or industry practices. In estimating a reasonable multiple, we consider not only the fact that our portfolio company may be a private company relative to a peer group of public comparables, but we also consider the size and scope of our portfolio company and its specific strengths and weaknesses. In some cases, the best valuation methodology may be a discounted cash flow analysis based on future projections. If a portfolio company is distressed, a liquidation analysis may provide the best indication of enterprise value.

If there is adequate enterprise value to support the repayment of our debt, the fair value of our loan or debt security normally corresponds to cost unless the borrower s condition or other factors lead to a determination of fair value at a different amount. The fair value of equity interests in portfolio companies is determined based on various factors, including the enterprise value remaining for equity holders after the repayment of the portfolio company s debt and other preference capital, and other pertinent factors such as recent offers to purchase a portfolio company, recent transactions involving the purchase or sale of the portfolio company s equity securities, liquidation events or other events. The determined equity values are generally discounted when we have a minority position, restrictions on resale, specific concerns about the receptivity of the capital markets to a specific company at a certain time, or other factors.

As a participant in the private equity business, we invest primarily in private middle market companies for which there is generally no publicly available information. Because of the private nature of these businesses, there is a need to maintain the confidentiality of the financial and other information that we have for the private companies in our portfolio. We believe that maintaining this confidence is important, as disclosure of such information could disadvantage our portfolio companies and could put us at a disadvantage in attracting new investments. Therefore, we do not intend to disclose financial or other information about our portfolio companies, unless required, because we believe doing so may put them at an economic or competitive disadvantage, regardless of our level of ownership or control.

We will continue to work with third-party consultants to obtain assistance in determining fair value for a portion of the private finance portfolio each quarter. We work with these consultants to obtain assistance as

additional support in the preparation of our internal valuation analysis. In addition, we may receive third-party assessments of a particular private finance portfolio company s value in the ordinary course of business, most often in the context of a prospective sale transaction or in the context of a bankruptcy process. The valuation analysis prepared by management using these third-party valuation resources, when applicable, is submitted to our Board of Directors for its determination of fair value of the portfolio in good faith.

For 2006 and 2005, we received third-party valuation assistance from Duff & Phelps, LLC and Houlihan Lokey Howard and Zukin for our private finance portfolio as follows:

	2006			2005		
	Q1	**Q2**	**Q3**	**Q1**	**Q2**	**Q3**
Number of private finance portfolio companies reviewed	78	78	105	36	72	89
Percentage of private finance portfolio reviewed at value	87.0%	89.6%	86.5%[(1)]	74.5%	83.0%	89.3%

(1) Of the remaining 13.5% of the private finance portfolio at value at September 30, 2006, 10.9% represented deals closed during the quarter ended September 30, 2006.

Professional fees for third-party valuation assistance were $1.4 million for the year ended December 31, 2005, and are estimated to be approximately $1.5 million for 2006.

Valuation Methodology CDO and CLO Bonds and Preferred Shares/Income Notes (CDO/CLO Assets). CDO/CLO Assets are carried at fair value, which is based on a discounted cash flow model that utilizes prepayment and loss assumptions based on historical experience and projected performance, economic factors, the characteristics of the underlying cash flow and comparable yields for similar bonds and preferred shares/income notes, when available. We recognize unrealized appreciation or depreciation on our CDO/CLO Assets as comparable yields in the market change and/or based on changes in estimated cash flows resulting from changes in prepayment or loss assumptions in the underlying collateral pool. As each bond ages, the expected amount of losses and the expected timing of recognition of such losses in the underlying collateral pool is updated and the revised cash flows are used in determining the fair value of the bonds. We determine the fair value of our CDO/CLO Assets on an individual security-by-security basis. If we were to sell a group of these CDO/CLO Assets in a pool in one or more transactions, the total value received for that pool may be different than the sum of the fair values of the individual bonds or preferred shares/income notes.

Net Change in Unrealized Appreciation or Depreciation. Net change in unrealized appreciation or depreciation for the three and nine months ended September 30, 2006 and 2005, consisted of the following:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
($ in millions)	**2006[(1)]**	**2005[(1)]**	**2006[(1)]**	**2005[(1)]**
Net unrealized appreciation or depreciation	$ 27.3	$ 69.4	$ 22.1	$ 213.7
Reversal of previously recorded unrealized appreciation associated with realized gains	(10.2)	(80.5)	(499.4)	(107.0)
	2.2	7.4	5.4	49.3

Reversal of previously recorded unrealized depreciation associated with realized losses				
Net change in unrealized appreciation or depreciation	$ 19.3	$ (3.7)	$ (471.9)	$ 156.0

(1) The net change in unrealized appreciation or depreciation can fluctuate significantly from period to period. As a result, quarterly comparisons may not be meaningful.

At September 30, 2006, our largest investment was in BLX. Our investment in BLX totaled $295.1 million at cost and $284.9 at value at September 30, 2006, and $299.4 million at cost and $357.1 million at value at December 31, 2005.

The following is a summary of the methodology that we used to determine the fair value of this investment.

Business Loan Express, LLC. To determine the value of our investment in BLX at September 30, 2006, we continued to perform four separate valuation analyses to determine a range of values: (1) analysis of comparable public company trading multiples, (2) analysis of BLX s value assuming an initial public offering, (3) analysis of merger and acquisition transactions for financial services companies, and (4) a discounted dividend analysis. In addition, for the quarter ended September 30, 2006, we performed a fifth analysis whereby the value of BLX was determined by adding BLX s net asset value (adjusted for certain discounts) to the value of BLX s business operations, which was determined by using a discounted cash flow model. We received valuation assistance from Duff & Phelps for our investment in BLX at September 30, 2006, and December 31, 2005.

With respect to the analysis of comparable public company trading multiples and the analysis of BLX s value assuming an initial public offering, we compute a median trailing and forward price earnings multiple to apply to BLX s pro-forma net income adjusted for certain capital structure changes that we believe would likely occur should the company be sold. Each quarter we evaluate which public commercial finance companies should be included in the comparable group. The comparable group at September 30, 2006, was made up of CIT Group, Inc., Financial Federal Corporation, GATX Corporation, and Marlin Business Services Corporation, which is consistent with the comparable group at June 30, 2006, and December 31, 2005.

Our investment in BLX at September 30, 2006, was valued at $284.9 million. This fair value was within the range of values determined by the five valuation analyses. Unrealized depreciation on our investment was $10.2 million at September 30, 2006. Net change in unrealized appreciation or depreciation included a net decrease on our investment in BLX of $34.3 million and $67.9 million for the three and nine months ended September 30, 2006, respectively. The decrease resulted from a reduction in enterprise value at September 30, 2006, of approximately 7% as compared to the enterprise value at December 31, 2005.

Furthermore, in determining the fair value of our investment in BLX at September 30, 2006, we considered the following items. First, the bank lending environment for small business loans remains very competitive and, as a result, BLX continues to experience significant loan prepayments in its securitized portfolio. This has also had an effect on BLX s ability to grow its new loan origination volume. Second, the Office of the Inspector General of the SBA and the Department of Justice have been conducting investigations into the lending activities of BLX and its Detroit office. These investigations are ongoing.

Per Share Amounts. All per share amounts included in the Management s Discussion and Analysis of Financial Condition and Results of Operations section have been computed using the weighted average common shares used to compute diluted earnings per share, which were 147.1 million and 138.1 million for the three months ended September 30, 2006 and 2005, respectively, and were 144.0 million and 136.7 million for the nine months ended September 30, 2006 and 2005, respectively.

OTHER MATTERS

Regulated Investment Company Status. We have elected to be taxed as a regulated investment company under Subchapter M of the Internal Revenue Code of 1986. As long as we qualify as a regulated investment company, we are not taxed on our investment company taxable income or realized net capital gains, to the extent that such taxable income or gains are distributed, or deemed to be distributed, to shareholders on a timely basis.

Taxable income generally differs from net income for financial reporting purposes due to temporary and permanent differences in the recognition of income and expenses, and generally excludes net unrealized appreciation or depreciation, as gains or losses are not included in taxable income until they are realized. In addition, gains realized

for financial reporting purposes may differ from gains included in taxable income as a result of our election to recognize gains using installment sale treatment, which results in the deferment of gains for tax purposes until notes or other amounts, including amounts held in escrow, received as consideration from the sale of investments are collected in cash.

Dividends declared and paid by us in a year generally differ from taxable income for that year as such dividends may include the distribution of current year taxable income, the distribution of prior year taxable income carried over into and distributed in the current year, or returns of capital. We are generally required to distribute 98% of our taxable income during the year the income is earned to avoid paying an excise tax. If this requirement is not met, the Internal Revenue Code imposes a nondeductible excise tax equal to 4% of the amount by which 98% of the current year s taxable income exceeds the distribution for the year. The taxable income on which an excise tax is paid is generally carried over and distributed to shareholders in the next tax year. Depending on the level of taxable income earned in a tax year, we may choose to carry over taxable income in excess of current year distributions from such taxable income into the next tax year and pay a 4% excise tax on such income, as required. See Financial Condition, Liquidity and Capital Resources below.

In order to maintain our status as a regulated investment company and obtain regulated investment company tax benefits, we must, in general, (1) continue to qualify as a business development company; (2) derive at least 90% of our gross income from dividends, interest, gains from the sale of securities and other specified types of income; (3) meet asset diversification requirements as defined in the Internal Revenue Code; and (4) timely distribute to shareholders at least 90% of our annual investment company taxable income as defined in the Internal Revenue Code. We intend to take all steps necessary to continue to qualify as a regulated investment company. However, there can be no assurance that we will continue to qualify for such treatment in future years.

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

Dividends and Distributions

Dividends to common shareholders for the nine months ended September 30, 2006 and 2005, were $255.4 million and $231.2 million, respectively, or $1.80 per common share for the nine months ended September 30, 2006 and $1.72 per common share for the nine months ended September 30, 2005. An extra cash dividend of $0.03 per common share was declared during 2005 and was paid to shareholders on January 27, 2006.

The Board of Directors has declared a dividend of $0.62 per common share for the fourth quarter of 2006.

Dividends are generally determined based upon an estimate of annual taxable income and the amount of taxable income carried over from the prior year for distribution in the current year. Taxable income includes our taxable interest, dividend and fee income, as well as taxable net capital gains. As discussed above, taxable income generally differs from net income for financial reporting purposes due to temporary and permanent differences in the recognition of income and expenses, and generally excludes net unrealized appreciation or depreciation, as gains or losses are not included in taxable income until they are realized. Taxable income includes non-cash income, such as changes in accrued and reinvested interest and dividends and the amortization of discounts and fees. Cash collections of income resulting from contractual payment-in-kind interest or the amortization of discounts and fees generally occur upon the repayment of the loans or debt securities that include such items. Non-cash taxable income is reduced by non-cash expenses, such as realized losses and depreciation and amortization expense.

Our Board of Directors reviews the dividend rate quarterly, and may adjust the quarterly dividend throughout the year. Dividends are declared based upon our estimate of annual taxable income available for distribution to shareholders and the amount of taxable income carried over from the prior year for distribution in the current year. Our goal is to declare what we believe to be sustainable increases in our regular quarterly dividends. To the extent that we earn annual taxable income in excess of dividends paid from such taxable income for the year, we may carry over the excess taxable income into the next year and such excess taxable income will be available for distribution in the next year as permitted under the Internal Revenue Code of 1986. Excess taxable income carried over and paid out in the next year is generally subject to a 4% excise tax. See Other Matters Regulated Investment Company Status above.

We believe that carrying over excess taxable income into future periods may provide increased visibility with respect to taxable earnings available to pay the regular quarterly dividend. The taxable income carried over from 2005 for distribution to shareholders in 2006 was $156.5 million.

We currently expect that our estimated annual taxable income for 2006 will be in excess of our estimated dividend distributions to shareholders in 2006 from such taxable income, and, therefore, we expect to carry over excess taxable income for distribution to shareholders in 2007. We expect that we will generally be required to pay a 4% excise tax on the excess of 98% of our taxable income for 2006 over the amount of actual distributions from such taxable income in 2006. Accordingly, for the nine months ended September 30, 2006, we have accrued an excise tax of $14.1 million. Excise taxes are accrued based upon estimated excess taxable income as estimated taxable income is earned, therefore, the excise tax accrued to date in 2006 may be adjusted as appropriate in the remainder of 2006 to reflect changes in our estimate of the carry over amount and additional excise tax may be accrued during the remainder of 2006 as additional excess taxable income is earned, if any. Our ability to earn the estimated annual taxable income for 2006 depends on many factors, including our ability to make new investments at attractive yields, the level of repayments in the portfolio, the realization of gains or losses from portfolio exits, and the level of operating expenses incurred. See Management s Discussion and Analysis of Financial Condition and Results of Operations and Risk Factors.

In addition to excess taxable income available to be carried over from the current tax year for distribution in the following tax year, we currently estimate that we have cumulative deferred taxable income related to installment sale gains of $39.6 million as of December 31, 2005, and approximately $170 million for the nine months ended September 30, 2006, for a total of approximately $210 million as of September 30, 2006. These gains have been recognized for financial reporting purposes in the respective years they were realized, but will be deferred for tax purposes until the notes or other amounts received from the sale of the related investments are collected in cash. The installment sale gains for 2006 are estimates and will not be finally determined until we file our 2006 tax return in September 2007. See Other Matters Regulated Investment Company Status above. To the extent that installment sale gains are deferred for recognition in taxable income, we pay interest to the Internal Revenue Service. Installment-related interest expense for the nine months ended September 30, 2006 and 2005, was $0.7 million and $0.4 million, respectively. This interest is included in interest expense in our Consolidated Statement of Operations.

Because we are a regulated investment company, we distribute our taxable income and, therefore, from time to time we will raise new debt or equity capital in order to fund our investments and operations.

Liquidity and Capital Resources

At September 30, 2006, and December 31, 2005, our liquidity portfolio (see below), cash and investments in money market and other securities, total assets, total debt outstanding, total shareholders equity, debt to equity ratio and asset coverage for senior indebtedness were as follows:

($ in millions)	**2006**	**2005**
Liquidity portfolio (including money market and other securities: 2006-$74.0; 2005-$100.0)	$ 201.6	$ 200.3
Cash and investments in money market and other securities (including money market and other securities: 2006-$42.9; 2005-$22.0)	$ 46.0	$ 53.3
Total assets	$ 4,565.5	$ 4,025.9
Total debt outstanding	$ 1,590.7	$ 1,284.8
Total shareholders equity	$ 2,823.9	$ 2,620.5
Debt to equity ratio[1]	0.56	0.49
Asset coverage ratio[2]	278%	309%

[1] The debt to equity ratio adjusted for the liquidity portfolio is 0.49 and 0.41 at September 30, 2006, and December 31, 2005, which is calculated as (a) total debt less the value of the liquidity portfolio divided by (b)

total shareholders equity.

(2) As a business development company, we are generally required to maintain a minimum ratio of 200% of total assets to total borrowings.

We have a liquidity portfolio that is composed of U.S. Treasury bills, money market securities and a certificate of deposit. At September 30, 2006, and December 31, 2005, the value and yield of the securities in the liquidity portfolio were as follows:

	2006		2005	
($ in millions)	**Value**	**Yield**	**Value**	**Yield**
U.S. Treasury bills[1]	$ 127.6	4.9%	$ 100.3	4.3%
Money market securities	34.0	5.2%	100.0	4.1%
Certificate of Deposit[1]	40.0	5.6%		
Total	$ 201.6	5.1%	$ 200.3	4.2%

(1) The Treasury bills and certificate of deposit mature in 2006.

The liquidity portfolio was established to provide a pool of liquid assets within our balance sheet. Our investment portfolio is primarily composed of private, illiquid assets for which there is no readily available market. Our portfolio s liquidity was reduced when we sold our portfolio of CMBS assets in May 2005, particularly BB rated bonds, which were generally more liquid than assets in our private finance portfolio. We assess the amount held in and the composition of the liquidity portfolio throughout the year.

We invest 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 securities. We place our cash with financial institutions and, at times, cash held in checking accounts in financial institutions may be in excess of the Federal Deposit Insurance Corporation insured limit.

During the nine months ended September 30, 2006, we sold new equity of $218.9 million in public offerings. We did not sell new equity in a public offering during the nine months ended September 30, 2005, or for the year ended December 31, 2005. In addition, shareholders equity increased by $23.2 million, $66.6 million and $77.5 million through the exercise of stock options, the collection of notes receivable from the sale of common stock, and the issuance of shares through our dividend reinvestment plan for the nine months ended September 30, 2006 and 2005, and the year ended December 31, 2005, respectively.

We employ an asset-liability management approach that focuses on matching the estimated maturities of our investment portfolio to the estimated maturities of our borrowings. We use our revolving line of credit facility as a means to bridge to long-term financing in the form of debt or equity capital, which may or may not result in temporary differences in the matching of estimated maturities. Availability on the revolving line of credit, net of amounts committed for standby letters of credit issued under the line of credit facility, was $877.0 million on September 30, 2006. We evaluate our interest rate exposure on an ongoing basis. Generally, we seek to fund our primarily fixed-rate investment portfolio with fixed-rate debt or equity capital. To the extent deemed necessary, we may hedge variable and short-term interest rate exposure through interest rate swaps or other techniques.

We currently target a debt to equity ratio ranging between 0.50:1.00 to 0.70:1.00 because we believe that it is prudent to operate with a larger equity capital base and less leverage.

At September 30, 2006, we had outstanding debt as follows:

($ in millions)	**Facility Amount**	**Amount Outstanding**	**Annual Interest Cost[1]**
Notes payable and debentures:			
Privately issued unsecured notes payable	$ 1,190.7	$ 1,190.7	6.2%
Publicly issued unsecured notes payable	400.0	400.0	6.8%
SBA debentures			