

ALLIED CAPITAL CORP  
Form 10-Q  
August 10, 2009

**FORM 10-Q**

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549**

**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

**For The Quarterly Period  
Ended June 30, 2009**

**Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

**Commission File Number:  
0-22832**

**ALLIED CAPITAL CORPORATION**  
*(Exact Name of Registrant as Specified in its Charter)*

**Maryland**  
*(State or Jurisdiction of  
Incorporation or Organization)*

**52-1081052**  
*(IRS Employer  
Identification No.)*

**1919 Pennsylvania Avenue, N.W.  
Washington, DC 20006**  
*(Address of Principal Executive Offices)*

**Registrant's telephone number, including area code: (202) 721-6100**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES  NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES  NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

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(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES  NO

On August 6, 2009, there were 179,011,774 shares outstanding of the Registrant's common stock, \$0.0001 par value.

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**ALLIED CAPITAL CORPORATION**

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**PART I: FINANCIAL INFORMATION****Item 1. Financial Statements****ALLIED CAPITAL CORPORATION AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEET**

<b>(in thousands, except per share amounts)</b>	<b>June 30, 2009 (unaudited)</b>	<b>December 31, 2008</b>
<b>ASSETS</b>		
Portfolio at value:		
Private finance		
Companies more than 25% owned (cost: 2009-\$2,037,757; 2008-\$2,167,020)	\$ 1,014,871	\$ 1,187,722
Companies 5% to 25% owned (cost: 2009-\$213,498; 2008-\$392,516)	161,368	352,760
Companies less than 5% owned (cost: 2009-\$2,000,141; 2008-\$2,317,856)	1,300,053	1,858,581
Total private finance (cost: 2009-\$4,251,396; 2008-\$4,877,392)	2,476,292	3,399,063
Commercial real estate finance (cost: 2009-\$73,663; 2008-\$85,503)	73,738	93,887
Total portfolio at value (cost: 2009-\$4,325,059; 2008-\$4,962,895)	2,550,030	3,492,950
Accrued interest and dividends receivable	44,600	55,638
Other assets	130,504	122,909
Investments in money market and other securities	415,025	287
Cash	68,985	50,402
Total assets	\$ 3,209,144	\$ 3,722,186
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Liabilities:		
Notes payable (maturing within one year: 2009-\$1,015,000; 2008-\$1,015,000)	\$ 1,760,544	\$ 1,895,000
Revolving line of credit	50,000	50,000
Accounts payable and other liabilities	57,271	58,786
Total liabilities	1,867,815	2,003,786
Commitments and contingencies		
Shareholders' equity:		
Common stock, \$0.0001 par value, 400,000 shares authorized; 179,012 and 178,692 shares issued and outstanding at June 30, 2009, and December 31, 2008, respectively	18	18
Additional paid-in capital	3,037,223	3,037,845
Notes receivable from sale of common stock	(805)	(1,089)
Net unrealized appreciation (depreciation)	(1,855,936)	(1,503,089)

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Undistributed earnings	160,829	184,715
Total shareholders' equity	1,341,329	1,718,400
Total liabilities and shareholders' equity	\$ 3,209,144	\$ 3,722,186
Net asset value per common share	\$ 7.49	\$ 9.62

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

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF OPERATIONS

(in thousands, except per share amounts)	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2009	2008	2009	2008
	(unaudited)		(unaudited)	
Interest and Related Portfolio Income:				
Interest and dividends				
Companies more than 25% owned	\$ 22,851	\$ 26,844	\$ 48,204	\$ 55,468
Companies 5% to 25% owned	9,212	9,049	20,348	21,723
Companies less than 5% owned	43,594	83,319	95,835	176,681
Total interest and dividends	75,657	119,212	164,387	253,872
Fees and other income				
Companies more than 25% owned	7,309	11,043	12,585	16,508
Companies 5% to 25% owned	193	16	210	69
Companies less than 5% owned	1,471	4,307	2,630	9,073
Total fees and other income	8,973	15,366	15,425	25,650
Total interest and related portfolio income	84,630	134,578	179,812	279,522
Expenses:				
Interest	43,117	36,465	86,602	74,025
Employee	10,964	13,344	22,034	35,996
Employee stock options	1,204	3,859	1,977	8,054
Administrative	8,459	12,943	18,304	21,962
Impairment of long-lived asset			2,873	
Total operating expenses	63,744	66,611	131,790	140,037
Net investment income before income taxes	20,886	67,967	48,022	139,485
Income tax expense (benefit), including excise tax	2,653	4,112	2,275	6,081
Net investment income	18,233	63,855	45,747	133,404
Net Realized and Unrealized Gains (Losses):				
Net realized gains (losses)				
Companies more than 25% owned	(72,912)	1,172	(76,962)	869
Companies 5% to 25% owned	(24,044)	(15,046)	(54,139)	(13,803)
Companies less than 5% owned	(29,100)	(3,981)	(22,064)	(1,778)

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Total net realized gains (losses)	(126,056)	(17,855)	(153,165)	(14,712)
Net change in unrealized appreciation or depreciation	(2,777)	(148,203)	(352,847)	(261,607)
Total net gains (losses)	(128,833)	(166,058)	(506,012)	(276,319)
Gain on repurchase of debt	81,537		83,532	
Net increase (decrease) in net assets resulting from operations	\$ (29,063)	\$ (102,203)	\$ (376,733)	\$ (142,915)
Basic earnings (loss) per common share	\$ (0.16)	\$ (0.59)	\$ (2.11)	\$ (0.85)
Diluted earnings (loss) per common share	\$ (0.16)	\$ (0.59)	\$ (2.11)	\$ (0.85)
Weighted average common shares outstanding basic	178,695	172,968	178,694	167,238
Weighted average common shares outstanding diluted	178,695	172,968	178,694	167,238

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

**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF CHANGES IN NET ASSETS**

(in thousands, except per share amounts)	<b>For the Six Months Ended June 30, 2009                      2008 (unaudited)</b>	
Operations:		
Net investment income	\$ 45,747	\$ 133,404
Net realized gains (losses)	(153,165)	(14,712)
Net change in unrealized appreciation or depreciation	(352,847)	(261,607)
Gain on repurchase of debt	83,532	
Net increase (decrease) in net assets resulting from operations	(376,733)	(142,915)
Shareholder distributions:		
Common stock dividends		(224,231)
Net decrease in net assets resulting from shareholder distributions		(224,231)
Capital share transactions:		
Sale of common stock		402,478
Issuance of common stock in lieu of cash distributions		3,751
Issuance of common stock upon exercise of stock options	233	
Stock option expense	2,046	8,180
Net decrease in notes receivable from sale of common stock	284	275
Purchase of common stock held in deferred compensation trusts		(943)
Distribution of common stock held in deferred compensation trusts		27,335
Other	(2,901)	
Net increase (decrease) in net assets resulting from capital share transactions	(338)	441,076
Total increase (decrease) in net assets	(377,071)	73,930
Net assets at beginning of period	1,718,400	2,771,847
Net assets at end of period	\$ 1,341,329	\$ 2,845,777
Net asset value per common share	\$ 7.49	\$ 15.93
Common shares outstanding at end of period	179,012	178,692



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

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF CASH FLOWS

(in thousands)	<b>For the Six Months Ended June 30, 2009                      2008 (unaudited)</b>	
Cash flows from operating activities:		
Net increase (decrease) in net assets resulting from operations	\$ (376,733)	\$ (142,915)
Adjustments:		
Portfolio investments	(98,734)	(593,959)
Principal collections related to investment repayments or sales	416,283	597,577
Collections of notes and other consideration received from sale of investments	171,030	10,455
Realized gains from the receipt of notes and other consideration from sale of investments		(1,886)
Realized losses	174,524	52,395
Gain on repurchase of debt	(83,532)	
Redemption of (investments in) U.S. Treasury bills, money market and other securities	(414,738)	101,173
Payment-in-kind interest and dividends, net of cash collections	(18,531)	(24,497)
Change in accrued interest and dividends	9,928	(5,942)
Net collection (amortization) of discounts and fees	(4,506)	(7,635)
Stock option expense	2,046	8,180
Impairment of long-lived asset	2,873	
Changes in other assets and liabilities	(65,152)	(58,377)
Depreciation and amortization	787	1,143
Net change in unrealized (appreciation) or depreciation	352,847	261,607
Net cash provided by (used in) operating activities	68,392	197,319
Cash flows from financing activities:		
Sale of common stock		402,478
Sale of common stock upon the exercise of stock options	233	
Collections of notes receivable from sale of common stock	284	275
Borrowings under notes payable		193,000
Repurchase or repayment of notes payable	(50,326)	(153,000)
Net borrowings under (repayments on) revolving line of credit		(286,750)
Purchase of common stock held in deferred compensation trusts		(943)
Other financing activities		(6,658)
Common stock dividends and distributions paid		(220,480)
Net cash provided by (used in) financing activities	(49,809)	(72,078)
Net increase (decrease) in cash	18,583	125,241
Cash at beginning of period	50,402	3,540

Cash at end of period	\$ 68,985	\$ 128,781
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The accompanying notes are an integral part of these consolidated financial statements.

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF INVESTMENTS

Private Finance Portfolio Company (in thousands, except number of shares) Companies More Than 25% Owned	Investment <sup>(1)(2)</sup>	June 30, 2009 (unaudited)		
		Principal	Cost	Value
AGILE Fund I, LLC <sup>(5)</sup>	Equity Interests		\$ 678	\$ 426
(Private Equity Fund)	<b>Total Investment</b>		<b>678</b>	<b>426</b>
AllBridge Financial, LLC (Asset Management)	Senior Loan (7.2%, Due 12/09)	\$ 398	398	398
	Equity Interests		34,865	8,047
	<b>Total Investment</b>		<b>35,263</b>	<b>8,445</b>
	Standby Letter of Credit (\$15,000)			
Allied Capital Senior Debt Fund, L.P. <sup>(5)</sup>	Limited Partnership Interests		31,800	33,044
(Private Debt Fund)	<b>Total Investment</b>		<b>31,800</b>	<b>33,044</b>
Avborne, Inc. <sup>(7)</sup> (Business Services)	Preferred Stock (12,500 shares)			904
	Common Stock (27,500 shares)			
	<b>Total Investment</b>			<b>904</b>
Avborne Heavy Maintenance, Inc. <sup>(7)</sup> (Business Services)	Common Stock (2,750 shares)			
	<b>Total Investment</b>			
Aviation Properties Corporation (Business Services)	Common Stock (100 shares)		93	
	<b>Total Investment</b>		<b>93</b>	
	Standby Letters of Credit (\$1,000)			
Border Foods, Inc. (Consumer Products)	Senior Loan (12.9%, Due 3/12)	34,876	29,199	34,876
	Preferred Stock (100,000 shares)		12,721	11,461

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	Common Stock (260,467 shares)		3,847	
	<b>Total Investment</b>		<b>45,767</b>	<b>46,337</b>
Calder Capital Partners, LLC <sup>(5)</sup> (Asset Management)	Senior Loan (12.5%, Due 5/09) <sup>(6)</sup>	4,496	4,496	980
	Equity Interests		2,453	
	<b>Total Investment</b>		<b>6,949</b>	<b>980</b>
Callidus Capital Corporation (Asset Management)	Subordinated Debt (18.0%, Due 8/13)	16,927	16,927	16,927
	Common Stock (100 shares)			21,012
	<b>Total Investment</b>		<b>16,927</b>	<b>37,939</b>
	Guaranty (\$6,447)			

- (1) Interest rates represent the weighted average annual stated interest rate on loans and debt securities, which are presented by nature of indebtedness for a single issuer. The maturity dates represent the earliest and the latest maturity dates.
- (2) Common stock, preferred stock, warrants, options, and equity interests are generally non-income producing and restricted.
- (5) Non-registered investment company.
- (6) Loan or debt security is on non-accrual status and therefore is considered non-income producing.
- (7) Avborne, Inc. and Avborne Heavy Maintenance, Inc. are affiliated companies.

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

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

Private Finance Portfolio Company (in thousands, except number of shares)	Investment <sup>(1)(2)</sup>	Principal	June 30, 2009 (unaudited)	
			Cost	Value
Ciena Capital LLC  (Financial Services)	Senior Loan (5.5%, Due 3/09) <sup>(6)</sup>  Class B Equity Interests Class C Equity Interests	\$ 319,031	\$ 319,031 119,436 109,097	\$ 93,043
	<b>Total Investment</b>		<b>547,564</b>	<b>93,043</b>
	Guaranty (\$5,000 See Note 3) Standby Letters of Credit (\$46,000 See Note 3)			
CitiPostal Inc.  (Business Services)	Senior Loan (3.8%, Due 12/13)  Unitranche Debt (12.0%, Due 12/13)  Subordinated Debt (16.0%, Due 12/15)  Common Stock (37,024 shares)	692  51,559  9,866	682  51,369  9,866  12,726	682  51,369  9,866
	<b>Total Investment</b>		<b>74,643</b>	<b>61,917</b>
Coverall North America, Inc.  (Business Services)	Unitranche Debt (12.0%, Due 7/11)  Subordinated Debt (15.0%, Due 7/11)  Common Stock (763,333 shares)	31,627  5,563	31,556  5,552  14,362	31,556  5,552  22,610
	<b>Total Investment</b>		<b>51,470</b>	<b>59,718</b>
CR Holding, Inc.  (Consumer Products)	Subordinated Debt (16.6%, Due 2/13) <sup>(6)</sup>  Common Stock (32,090,696 shares)	40,623	40,510  28,744	10,710
	<b>Total Investment</b>		<b>69,254</b>	<b>10,710</b>

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Crescent Equity Corp. <sup>(8)</sup>	Senior Loan (10.0%, Due 6/10)	433	433	433
(Business Services)	Subordinated Debt (11.0%, Due 9/11 - 6/17) <sup>(6)</sup>	32,305	32,216	4,378
	Common Stock (174 shares)		83,194	
	<b>Total Investment</b>		<b>115,843</b>	<b>4,811</b>
	Guaranty (\$900)			
Direct Capital Corporation	Senior Loan (8.0%, Due 1/14) <sup>(6)</sup>	8,175	8,175	8,405
(Financial Services)	Subordinated Debt (16.0%, Due 3/13) <sup>(6)</sup>	55,671	55,496	7,109
	Common Stock (2,317,020 shares)		25,732	
	<b>Total Investment</b>		<b>89,403</b>	<b>15,514</b>
Financial Pacific Company	Subordinated Debt (17.4%, Due 2/12 - 8/12)	68,967	68,860	49,696
(Financial Services)	Preferred Stock (9,458 shares)		8,865	
	Common Stock (12,711 shares)		12,783	
	<b>Total Investment</b>		<b>90,508</b>	<b>49,696</b>

- (1) Interest rates represent the weighted average annual stated interest rate on loans and debt securities, which are presented by nature of indebtedness for a single issuer. The maturity dates represent the earliest and the latest maturity dates.
- (2) Common stock, preferred stock, warrants, options, and equity interests are generally non-income producing and restricted.
- (6) Loan or debt security is on non-accrual status and therefore is considered non-income producing.
- (8) Crescent Equity Corp. holds investments in Crescent Hotels & Resorts, LLC and affiliates.

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

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

Private Finance Portfolio Company (in thousands, except number of shares)	Investment <sup>(1)(2)</sup>	June 30, 2009 (unaudited)		Value
		Principal	Cost	
Global Communications, LLC	Senior Loan (10.0%, Due 9/02) <sup>(6)</sup>	\$ 1,335	\$ 1,335	\$ 992
(Business Services)	<b>Total Investment</b>		<b>1,335</b>	<b>992</b>
Hot Light Brands, Inc. (Retail)	Senior Loan (9.0%, Due 2/11) <sup>(6)</sup>	30,572	30,572	12,010
	Common Stock (93,500 shares)		5,151	
	<b>Total Investment</b>		<b>35,723</b>	<b>12,010</b>
Hot Stuff Foods, LLC	Senior Loan (3.8%, Due 2/11-2/12)	50,777	50,658	50,658
(Consumer Products)	Subordinated Debt (12.4%, Due 8/12-2/13) <sup>(6)</sup>	83,692	83,387	16,143
	Common Stock (1,147,453 shares)		56,187	
	<b>Total Investment</b>		<b>190,232</b>	<b>66,801</b>
Huddle House, Inc. (Retail)	Subordinated Debt (15.0%, Due 12/15)	19,473	19,429	19,429
	Common Stock (358,428 shares)		36,348	18,411
	<b>Total Investment</b>		<b>55,777</b>	<b>37,840</b>
IAT Equity, LLC and Affiliates d/b/a Industrial Air Tool	Subordinated Debt (9.0%, Due 6/14)	6,000	6,000	6,000
	Equity Interests		7,500	9,250
(Industrial Products)	<b>Total Investment</b>		<b>13,500</b>	<b>15,250</b>
Impact Innovations Group, LLC (Business Services)	Equity Interests in Affiliate			322
	<b>Total Investment</b>			<b>322</b>



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Insight Pharmaceuticals Corporation (Consumer Products)	Subordinated Debt (15.0%, Due 9/12) Common Stock (155,000 shares)	54,124	54,050 40,413	54,050 11,033
	<b>Total Investment</b>		<b>94,463</b>	<b>65,083</b>
Jakel, Inc. (Industrial Products)	Subordinated Debt (15.5%, Due 3/08) <sup>(6)</sup>	748	748	374
	<b>Total Investment</b>		<b>748</b>	<b>374</b>
Knightsbridge CLO 2007-1 Ltd. <sup>(4)</sup> (CLO)	Class E Notes (10.1%, Due 1/22) Income Notes (13.6%) <sup>(11)</sup>	18,700	18,700 39,556	11,341 25,858
	<b>Total Investment</b>		<b>58,256</b>	<b>37,199</b>
Knightsbridge CLO 2008-1 Ltd. <sup>(4)</sup> (CLO)	Class C Notes (8.1%, Due 6/18) Class D Notes (9.1%, Due 6/18) Class E Notes (5.6%, Due 6/18) Income Notes (17.3%) <sup>(11)</sup>	12,800 8,000 13,200	12,800 8,000 10,879 21,230	12,173 6,985 8,896 18,279
	<b>Total Investment</b>		<b>52,909</b>	<b>46,333</b>

- (1) Interest rates represent the weighted average annual stated interest rate on loans and debt securities, which are presented by nature of indebtedness for a single issuer. The maturity dates represent the earliest and the latest maturity dates.
- (2) Common stock, preferred stock, warrants, options, and equity interests are generally non-income producing and restricted.
- (4) Non-U.S. company or principal place of business outside the U.S.
- (6) Loan or debt security is on non-accrual status and therefore is considered non-income producing.
- (11) Represents the effective interest yield earned on the cost basis of these preferred equity investments and income notes. The yield is included in interest income in the consolidated statement of operations.

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

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

Private Finance Portfolio Company (in thousands, except number of shares)	Investment <sup>(1)(2)</sup>	Principal	June 30, 2009 (unaudited) Cost	Value
MVL Group, Inc.	Senior Loan (12.0%, Due 7/12)	\$ 25,260	\$ 25,256	\$ 25,256
(Business Services)	Subordinated Debt (14.5%, Due 7/12)	41,434	41,399	33,843
	Subordinated Debt (8.0%, Due 7/12) <sup>(6)</sup>	144	139	
	Common Stock (560,716 shares)		555	
	<b>Total Investment</b>		<b>67,349</b>	<b>59,099</b>
Penn Detroit Diesel Allison, LLC	Equity Interests		20,081	20,005
(Business Services)	<b>Total Investment</b>		<b>20,081</b>	<b>20,005</b>
Senior Secured Loan Fund LLC	Subordinated Certificates (8.9%)		166,293	154,200
(Private Debt Fund)	Equity Interests		1	
	<b>Total Investment</b>		<b>166,294</b>	<b>154,200</b>
Service Champ, Inc.	Subordinated Debt (15.5%, Due 4/12)	27,393	27,337	27,337
(Business Services)	Common Stock (55,112 shares)		11,785	22,676
	<b>Total Investment</b>		<b>39,122</b>	<b>50,013</b>
Stag-Parkway, Inc.	Subordinated Debt (10.0%, Due 7/12)	19,044	18,997	18,997
(Business Services)	Common Stock (25,000 shares)		32,686	5,950
	<b>Total Investment</b>		<b>51,683</b>	<b>24,947</b>
Startec Equity, LLC	Equity Interests		211	

(Telecommunications)	<b>Total Investment</b>		<b>211</b>	
Worldwide Express Operations, LLC	Subordinated Debt (14.0%, Due 2/14) <sup>(6)</sup>	2,827	2,684	919
(Business Services)	Equity Interests		11,084	
	Warrants		144	
	<b>Total Investment</b>		<b>13,912</b>	<b>919</b>
<b>Total companies more than 25% owned</b>			<b>\$ 2,037,757</b>	<b>\$ 1,014,871</b>
<b>Companies 5% to 25% Owned</b>				
10 <sup>th</sup> Street, LLC	Subordinated Debt (13.0%, Due 11/14)	\$ 21,877	\$ 21,777	\$ 21,877
(Business Services)	Equity Interests		422	505
	Option		25	25
	<b>Total Investment</b>		<b>22,224</b>	<b>22,407</b>
Air Medical Group Holdings LLC	Senior Loan (4.3%, Due 3/11)			
(Healthcare Services)	Equity Interests		2,966	12,473
	<b>Total Investment</b>		<b>2,966</b>	<b>12,473</b>
BB&T Capital Partners/Windsor Mezzanine Fund, LLC <sup>(5)</sup>	Equity Interests		11,789	9,680
(Private Equity Fund)	<b>Total Investment</b>		<b>11,789</b>	<b>9,680</b>

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## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

Private Finance Portfolio Company (in thousands, except number of shares)	Investment <sup>(1)(2)</sup>	Principal	June 30, 2009 (unaudited)	
			Cost	Value
Driven Brands, Inc.  (Consumer Services)	Subordinated Debt (16.5%, Due 7/15) Common Stock (3,772,098 shares)	\$ 87,800	\$ 87,424	\$ 84,032
	<b>Total Investment</b>		<b>96,940</b>	<b>86,232</b>
Multi-Ad Services, Inc.  (Business Services)	Unitranche Debt (11.3%, Due 11/11) Equity Interests	2,516	2,497	2,453
	<b>Total Investment</b>		<b>4,234</b>	<b>3,700</b>
Pendum Acquisition, Inc.  (Business Services)	Common Stock (8,872 shares)			
	<b>Total Investment</b>			
Postle Aluminum Company, LLC  (Industrial Products)	Senior Loan (6.0%, Due 10/12) <sup>(6)</sup> Subordinated Debt (3.0%, Due 10/12) <sup>(6)</sup> Equity Interests	35,000	34,876	14,369
	<b>Total Investment</b>		<b>60,918</b>	<b>14,369</b>
Progressive International Corporation (Consumer Products)	Preferred Stock (500 shares) Common Stock (197 shares) Warrants		500	1,171
	<b>Total Investment</b>		<b>513</b>	<b>5,071</b>
Regency Healthcare Group, LLC  (Healthcare Services)	Equity Interests		1,302	1,817
	<b>Total Investment</b>		<b>1,302</b>	<b>1,817</b>

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SGT India Private Limited <sup>(4)</sup>	Common Stock (150,596 shares)		4,142	
(Business Services)	<b>Total Investment</b>		<b>4,142</b>	
Soteria Imaging Services, LLC	Subordinated Debt (11.3%, Due 11/10)	4,250	4,192	4,095
(Healthcare Services)	Equity Interests		1,881	1,515
	<b>Total Investment</b>		<b>6,073</b>	<b>5,610</b>
Triax Holdings, LLC	Equity Interests		798	9
(Consumer Products)	<b>Total Investment</b>		<b>798</b>	<b>9</b>
Universal Environmental Services, LLC	Equity Interests		1,599	
(Business Services)	<b>Total Investment</b>		<b>1,599</b>	
<b>Total companies 5% to 25% owned</b>			<b>\$ 213,498</b>	<b>\$ 161,368</b>
<b>Companies Less Than 5% Owned</b>				
3SI Security Systems, Inc.	Subordinated Debt (16.0%, Due 8/13)	\$ 20,500	\$ 20,443	\$ 17,869
(Consumer Products)	Subordinated Debt (18.0%, Due 8/13) <sup>(6)</sup>	9,048	9,030	
	<b>Total Investment</b>		<b>29,473</b>	<b>17,869</b>
Augusta Sportswear Group, Inc.	Common Stock (2,500 shares)		2,500	1,400
(Consumer Products)	<b>Total Investment</b>		<b>2,500</b>	<b>1,400</b>

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## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

<b>Private Finance Portfolio Company (in thousands, except number of shares)</b>	<b>Investment<sup>(1)(2)</sup></b>	<b>Principal</b>	<b>June 30, 2009 (unaudited)</b>	
			<b>Cost</b>	<b>Value</b>
Axiom Healthcare Pharmacy, Inc.	Subordinated Debt (8.0%, Due 3/15)	\$ 2,975	\$ 2,975	\$ 2,380
(Healthcare Services)	<b>Total Investment</b>		<b>2,975</b>	<b>2,380</b>
Baird Capital Partners IV Limited <sup>(5)</sup>	Limited Partnership Interest		3,636	2,413
(Private Equity Fund)	<b>Total Investment</b>		<b>3,636</b>	<b>2,413</b>
BenefitMall Holdings Inc.	Subordinated Debt (18.0%, Due 6/14)	40,326	40,246	40,246
(Business Services)	Common Stock (39,274,290 shares) <sup>(12)</sup> Warrants <sup>(12)</sup>		39,274	74,761
	<b>Total Investment</b>		<b>79,520</b>	<b>115,007</b>
Broadcast Electronics, Inc.	Senior Loan (8.8%, Due 11/11) <sup>(6)</sup>	4,882	4,855	630
(Business Services)	Preferred Stock (2,044 shares)			
	<b>Total Investment</b>		<b>4,855</b>	<b>630</b>
Bushnell, Inc.	Subordinated Debt (7.1%, Due 2/14)	41,325	40,106	29,901
(Consumer Products)	<b>Total Investment</b>		<b>40,106</b>	<b>29,901</b>
Callidus Debt Partners	Class C Notes (12.9%, Due 12/13) <sup>(6)</sup>	19,420	19,527	4,926
CDO Fund I, Ltd. <sup>(4)(10)</sup>	Class D Notes (17.0%, Due 12/13) <sup>(6)</sup>	9,400	9,454	
(CDO)	<b>Total Investment</b>		<b>28,981</b>	<b>4,926</b>

Callidus Debt Partners	Preferred Shares (23,600,000 shares)		20,138	1,492
CLO Fund III, Ltd. <sup>(4)(10)</sup>				
(CLO)	<b>Total Investment</b>		<b>20,138</b>	<b>1,492</b>
Callidus Debt Partners	Class D Notes (5.7%, Due 4/20)	3,000	2,116	1,649
CLO Fund IV, Ltd. <sup>(4)(10)</sup>	Income Notes (0.0%) <sup>(11)</sup>		14,979	4,166
(CLO)	<b>Total Investment</b>		<b>17,095</b>	<b>5,815</b>
Callidus Debt Partners	Income Notes (0.7%) <sup>(11)</sup>		13,698	4,594
CLO Fund V, Ltd. <sup>(4)(10)</sup>				
(CLO)	<b>Total Investment</b>		<b>13,698</b>	<b>4,594</b>
Callidus Debt Partners	Class D Notes (7.1%, Due 10/21)	9,160	7,388	3,751
CLO Fund VI, Ltd. <sup>(4)(10)</sup>	Income Notes (0.0%) <sup>(11)</sup>		29,144	5,629
(CLO)	<b>Total Investment</b>		<b>36,532</b>	<b>9,380</b>
Callidus Debt Partners	Income Notes (0.0%) <sup>(11)</sup>		24,824	4,772
CLO Fund VII, Ltd. <sup>(4)(10)</sup>				
(CLO)	<b>Total Investment</b>		<b>24,824</b>	<b>4,772</b>

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## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

Private Finance Portfolio Company (in thousands, except number of shares)	Investment <sup>(1)(2)</sup>	Principal	June 30, 2009 (unaudited)	
			Cost	Value
Callidus MAPS CLO Fund I LLC <sup>(10)</sup> (CLO)	Class E Notes (6.1%, Due 12/17)	\$ 17,000	\$ 17,000	\$ 10,200
	Income Notes (0.0%) <sup>(11)</sup>		42,492	12,388
	<b>Total Investment</b>		<b>59,492</b>	<b>22,588</b>
Callidus MAPS CLO Fund II, Ltd. <sup>(4)(10)</sup> (CLO)	Class D Notes (5.4%, Due 7/22)	7,700	3,696	3,037
	Income Notes (0.0%) <sup>(11)</sup>		18,300	4,164
	<b>Total Investment</b>		<b>21,996</b>	<b>7,201</b>
Carlisle Wide Plank Floors, Inc. (Consumer Products)	Senior Loan (4.2%, Due 6/11)	500	498	409
	Unitranche Debt (12.8%, Due 6/11)	3,161	3,143	2,585
	Preferred Stock (345,056 Shares)		345	
	<b>Total Investment</b>		<b>3,986</b>	<b>2,994</b>
Catterton Partners VI, L.P. <sup>(5)</sup> (Private Equity Fund)	Limited Partnership Interest		2,952	1,521
	<b>Total Investment</b>		<b>2,952</b>	<b>1,521</b>
Centre Capital Investors V, L.P. <sup>(5)</sup> (Private Equity Fund)	Limited Partnership Interest		2,798	1,715
	<b>Total Investment</b>		<b>2,798</b>	<b>1,715</b>
CK Franchising, Inc. (Consumer Services)	Senior Loan (5.5%, Due 7/12)	300	286	286
	Subordinated Debt (12.3%, Due 7/12 7/17)	21,152	21,090	21,090
	Preferred Stock (1,281,887 shares)		1,282	1,710
	Common Stock (7,585,549 shares)		7,586	16,497
	<b>Total Investment</b>		<b>30,244</b>	<b>39,583</b>

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Commercial Credit Group, Inc.	Subordinated Debt (15.0%, Due 6/15)	22,000	21,970	21,970
(Financial Services)	Preferred Stock (64,679 shares) Warrants		15,543	8,783
	<b>Total Investment</b>		<b>37,513</b>	<b>30,753</b>
Community Education Centers, Inc.	Subordinated Debt (19.5%, Due 11/13)	35,972	35,916	35,972
(Education Services)	<b>Total Investment</b>		<b>35,916</b>	<b>35,972</b>
Component Hardware Group, Inc.	Subordinated Debt (13.5%, Due 1/13)	18,851	18,802	16,303
(Industrial Products)	<b>Total Investment</b>		<b>18,802</b>	<b>16,303</b>
Cook Inlet Alternative Risk, LLC	Unitranche Debt (10.8%, Due 4/13)	87,600	87,264	69,000
(Business Services)	Equity Interests		552	
	<b>Total Investment</b>		<b>87,816</b>	<b>69,000</b>
Cortec Group Fund IV, L.P. <sup>(5)</sup>	Limited Partnership Interest		4,970	2,717
(Private Equity)	<b>Total Investment</b>		<b>4,970</b>	<b>2,717</b>

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## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

<b>Private Finance Portfolio Company (in thousands, except number of shares)</b>	<b>Investment<sup>(1)(2)</sup></b>	<b>June 30, 2009 (unaudited)</b>		
	<b>Principal</b>	<b>Cost</b>	<b>Value</b>	
Digital VideoStream, LLC	Unitranche Debt (11.0%, Due 2/12)	\$ 13,676	\$ 13,622	\$ 13,478
(Business Services)	Convertible Subordinated Debt (10.0%, Due 2/16)	4,775	4,764	4,764
	<b>Total Investment</b>		<b>18,386</b>	<b>18,242</b>
DirectBuy Holdings, Inc.	Subordinated Debt (14.5%, Due 5/13)	76,389	76,122	59,663
(Consumer Products)	Equity Interests		8,000	
	<b>Total Investment</b>		<b>84,122</b>	<b>59,663</b>
Distant Lands Trading Co.	Senior Loan (6.3%, Due 11/11)	10,000	9,979	9,240
(Consumer Products)	Unitranche Debt (11.0%, Due 11/11)	43,499	43,408	41,571
	Common Stock (3,451 shares)		3,451	1,077
	<b>Total Investment</b>		<b>56,838</b>	<b>51,888</b>
Diversified Mercury	Senior Loan (4.5%, Due 3/13)	2,960	2,948	2,593
Communications, LLC	<b>Total Investment</b>		<b>2,948</b>	<b>2,593</b>
(Business Services)				
Dryden XVIII Leveraged Loan 2007 Limited <sup>(4)</sup>	Class B Notes (5.6%, Due 10/19) <sup>(6)</sup>	9,092	7,872	2,271
	Income Notes (0.0%) <sup>(11)</sup>		23,164	773
(CLO)	<b>Total Investment</b>		<b>31,036</b>	<b>3,044</b>
Dynamic India Fund IV <sup>(4)(5)</sup>	Equity Interests		9,350	9,540
(Private Equity Fund)	<b>Total Investment</b>		<b>9,350</b>	<b>9,540</b>

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EarthColor, Inc.	Subordinated Debt (15.0%, Due 11/13) <sup>(6)</sup>	123,819	123,385	
(Business Services)	Common Stock (63,438 shares) <sup>(12)</sup> Warrants <sup>(12)</sup>		63,438	
	<b>Total Investment</b>		<b>186,823</b>	
eCentury Capital Partners, L.P. <sup>(5)</sup>	Limited Partnership Interest		7,274	112
(Private Equity Fund)	<b>Total Investment</b>		<b>7,274</b>	<b>112</b>
eInstruction Corporation	Subordinated Debt (12.1%, Due 7/14-1/15)	35,328	35,204	31,981
(Education Services)	Common Stock (2,406 shares)		2,500	850
	<b>Total Investment</b>		<b>37,704</b>	<b>32,831</b>
Farley s & Sathers Candy Company, Inc.	Subordinated Debt (8.3%, Due 3/11)	2,500	2,495	2,393
(Consumer Products)	<b>Total Investment</b>		<b>2,495</b>	<b>2,393</b>

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## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

<b>Private Finance Portfolio Company (in thousands, except number of shares)</b>	<b>Investment<sup>(1)(2)</sup></b>	<b>Principal</b>	<b>June 30, 2009 (unaudited)</b>	
			<b>Cost</b>	<b>Value</b>
Fidus Mezzanine Capital, L.P. <sup>(5)</sup>	Limited Partnership Interest		\$ 12,828	\$ 8,325
(Private Equity Fund)	<b>Total Investment</b>		<b>12,828</b>	<b>8,325</b>
Freedom Financial Network, LLC	Subordinated Debt (13.5%, Due 2/14)	\$ 8,000	7,950	8,000
(Financial Services)	<b>Total Investment</b>		<b>7,950</b>	<b>8,000</b>
Geotrace Technologies, Inc.	Warrants		2,027	2,335
(Energy Services)	<b>Total Investment</b>		<b>2,027</b>	<b>2,335</b>
Gilchrist & Soames, Inc. (Consumer Products)	Subordinated Debt (13.4%, Due 10/13)	25,304	25,179	23,079
	<b>Total Investment</b>		<b>25,179</b>	<b>23,079</b>
Havco Wood Products LLC	Equity Interests		910	
(Industrial Products)	<b>Total Investment</b>		<b>910</b>	
Higginbotham Insurance Agency, Inc.	Subordinated Debt (13.7%, Due 8/13 8/14)	53,305	53,109	53,109
(Business Services)	Common Stock (23,695 shares) <sup>(12)</sup> Warrant <sup>(12)</sup>		23,695	14,190
	<b>Total Investment</b>		<b>76,804</b>	<b>67,299</b>
The Homax Group, Inc. (Consumer Products)	Senior Loan (6.4%, Due 10/12)	10,194	10,150	9,110
	Subordinated Debt (14.5%, Due 4/14)	14,159	13,589	6,986
	Preferred Stock (76 shares)		76	
	Common Stock (24 shares)		5	

	Warrants		954	
	<b>Total Investment</b>		<b>24,774</b>	<b>16,096</b>
Ideal Snacks Corporation	Senior Loan (7.3%, Due 6/10)	1,333	1,333	1,290
(Consumer Products)	<b>Total Investment</b>		<b>1,333</b>	<b>1,290</b>
Kodiak Fund LP <sup>(5)</sup>	Equity Interests		9,350	900
(Private Equity Fund)	<b>Total Investment</b>		<b>9,350</b>	<b>900</b>
Market Track Holdings, LLC	Senior Loan (8.0%, Due 6/14)	2,500	2,450	2,483
(Business Services)	Subordinated Debt (15.9%, Due 6/14)	24,600	24,499	23,306
	<b>Total Investment</b>		<b>26,949</b>	<b>25,789</b>
NetShape Technologies, Inc.	Senior Loan (4.1%, Due 2/13)	875	875	445
(Industrial Products)	<b>Total Investment</b>		<b>875</b>	<b>445</b>

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## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

<b>Private Finance Portfolio Company (in thousands, except number of shares)</b>	<b>Investment<sup>(1)(2)</sup></b>	<b>June 30, 2009 (unaudited)</b>		
		<b>Principal</b>	<b>Cost</b>	<b>Value</b>
Network Hardware Resale, Inc. (Business Services)	Unitranche Debt (12.8%, Due 12/11) Convertible Subordinated Debt (9.8%, Due 12/15)	\$ 16,618	\$ 16,676	\$ 16,618
	<b>Total Investment</b>		<b>32,678</b>	<b>32,620</b>
Novak Biddle Venture Partners III, L.P. <sup>(5)</sup> (Private Equity Fund)	Limited Partnership Interest		2,018	1,221
	<b>Total Investment</b>		<b>2,018</b>	<b>1,221</b>
Oahu Waste Services, Inc. (Business Services)	Stock Appreciation Rights		206	385
	<b>Total Investment</b>		<b>206</b>	<b>385</b>
Pangaea CLO 2007-1 Ltd. <sup>(4)</sup> (CLO)	Class D Notes (5.9%, Due 1/21)	15,000	11,919	6,190
	<b>Total Investment</b>		<b>11,919</b>	<b>6,190</b>
PC Helps Support, LLC (Business Services)	Senior Loan (3.6%, Due 12/13) Subordinated Debt (12.8%, Due 12/13)	8,417	8,328	7,795
	<b>Total Investment</b>	27,507	27,393	25,948
	<b>Total Investment</b>		<b>35,721</b>	<b>33,743</b>
Performant Financial Corporation (Business Services)	Common Stock (478,816 shares)		734	560
	<b>Total Investment</b>		<b>734</b>	<b>560</b>
Promo Works, LLC (Business Services)	Unitranche Debt (12.3%, Due 12/11)	23,111	22,980	17,566
	<b>Total Investment</b>		<b>22,980</b>	<b>17,566</b>



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Reed Group, Ltd. (Healthcare Services)	Senior Loan (7.0%, Due 12/13)	12,338	12,206	10,946
	Subordinated Debt (15.8%, Due 12/13)	18,897	18,830	16,383
	Equity Interests		1,800	245
	<b>Total Investment</b>		<b>32,836</b>	<b>27,574</b>
S.B. Restaurant Company (Retail)	Unitranche Debt (9.8%, Due 4/11)	38,327	38,160	34,036
	Preferred Stock (46,690 shares)		117	117
	Warrants		534	
	<b>Total Investment</b>		<b>38,811</b>	<b>34,153</b>
Snow Phipps Group, L.P. <sup>(5)</sup> (Private Equity Fund)	Limited Partnership Interest		5,850	4,308
	<b>Total Investment</b>		<b>5,850</b>	<b>4,308</b>
SPP Mezzanine Funding II, L.P. <sup>(5)</sup> (Private Equity Fund)	Limited Partnership Interest		9,097	7,949
	<b>Total Investment</b>		<b>9,097</b>	<b>7,949</b>
STS Operating, Inc. (Industrial Products)	Subordinated Debt (11.0%, Due 1/13)	30,386	30,307	27,378
	<b>Total Investment</b>		<b>30,307</b>	<b>27,378</b>
Summit Energy Services, Inc. (Business Services)	Common Stock (415,982 shares)		1,861	2,100
	<b>Total Investment</b>		<b>1,861</b>	<b>2,100</b>

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## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

Private Finance Portfolio Company (in thousands, except number of shares)	Investment <sup>(1)(2)</sup>	Principal	June 30, 2009 (unaudited) Cost	Value
Tappan Wire & Cable Inc.  (Business Services)	Unitranche Debt (15.0%, Due 8/14) <sup>(6)</sup> Common Stock (12,940 shares) <sup>(12)</sup> Warrant <sup>(12)</sup>	\$ 22,346	\$ 22,248	\$ 6,961
	<b>Total Investment</b>		<b>24,291</b>	<b>6,961</b>
The Step2 Company, LLC  (Consumer Products)	Unitranche Debt (11.0%, Due 4/12) Equity Interests	94,843	94,616 2,156	89,432 1,376
	<b>Total Investment</b>		<b>96,772</b>	<b>90,808</b>
Tradesmen International, Inc.  (Business Services)	Subordinated Debt (12.0%, Due 12/12)	40,000	39,723	34,413
	<b>Total Investment</b>		<b>39,723</b>	<b>34,413</b>
TransAmerican Auto Parts, LLC  (Consumer Products)	Subordinated Debt (18.3%, Due 11/12) <sup>(6)</sup> Equity Interests	24,561	24,409 1,034	
	<b>Total Investment</b>		<b>25,443</b>	
Trover Solutions, Inc.  (Business Services)	Subordinated Debt (12.0%, Due 11/12)	56,676	56,496	53,019
	<b>Total Investment</b>		<b>56,496</b>	<b>53,019</b>
United Road Towing, Inc.  (Consumer Services)	Subordinated Debt (11.8%, Due 1/14)	19,060	18,984	18,641
	<b>Total Investment</b>		<b>18,984</b>	<b>18,641</b>

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Venturehouse-Cibernet Investors, LLC	Equity Interest			
(Business Services)	<b>Total Investment</b>			
WMA Equity Corporation and Affiliates	Subordinated Debt (16.8%, Due 4/13-4/14) <sup>(6)</sup>	139,455	138,559	60,000
d/b/a Wear Me Apparel	Common Stock (86 shares)		39,635	
(Consumer Products)	<b>Total Investment</b>		<b>178,194</b>	<b>60,000</b>
Webster Capital II, L.P. <sup>(5)</sup>	Limited Partnership Interest		1,929	1,649
(Private Equity Fund)	<b>Total Investment</b>		<b>1,929</b>	<b>1,649</b>
Woodstream Corporation	Subordinated Debt (12.0%, Due 2/15)	90,000	89,663	73,064
(Consumer Products)	Common Stock (6,960 shares)		6,961	1,100
	<b>Total Investment</b>		<b>96,624</b>	<b>74,164</b>
Other companies	Other debt investments	37	(147)	(147)
	Other equity investments		41	8
	<b>Total Investment</b>		<b>(106)</b>	<b>(139)</b>
<b>Total companies less than 5% owned</b>			<b>\$ 2,000,141</b>	<b>\$ 1,300,053</b>
<b>Total private finance (120 portfolio investments)</b>			<b>\$ 4,251,396</b>	<b>\$ 2,476,292</b>

- (1) Interest rates represent the weighted average annual stated interest rate on loans and debt securities, which are presented by nature of indebtedness for a single issuer. The maturity dates represent the earliest and the latest maturity dates.
- (2) Common stock, preferred stock, warrants, options, and equity interests are generally non-income producing and restricted.
- (5) Non-registered investment company.
- (6) Loan or debt security is on non-accrual status and therefore is considered non-income producing.
- (12) Common stock is non-voting. In addition to non-voting stock ownership, the Company has an option to acquire a majority of the voting securities of the portfolio company at fair market value.

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



## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

Commercial Real Estate Finance  
(in thousands, except number of loans)

			June 30, 2009 (unaudited)	
	Stated Interest Rate Ranges	Number of Loans	Cost	Value
<b>Commercial Mortgage Loans</b>				
	Up to 6.99%	3	\$ 31,385	\$ 30,097
	7.00% 8.99%	2	1,946	1,929
	9.00% 10.99%	1	6,472	6,472
	11.00% 12.99%	1	10,475	9,051
	15.00% and above	2	3,970	5,485
<b>Total commercial mortgage loans<sup>(13)</sup></b>			<b>\$ 54,248</b>	<b>\$ 53,034</b>
<b>Real Estate Owned</b>			<b>\$ 5,920</b>	<b>\$ 6,579</b>
<b>Equity Interests<sup>(2)</sup> Companies more than 25% owned</b>			<b>\$ 13,495</b>	<b>\$ 14,125</b>
Guarantees (\$6,871)				
<b>Total commercial real estate finance</b>			<b>\$ 73,663</b>	<b>\$ 73,738</b>
<b>Total portfolio</b>			<b>\$ 4,325,059</b>	<b>\$ 2,550,030</b>

	Yield	Cost	Value
<b>Investments in Money Market and Other Securities</b>			
First American Treasury Obligations Fund		\$ 415,020	\$ 415,020
SEI Daily Income Tr Prime Obligation Money Market Fund	0.3 %	5	5
Total		\$ 415,025	\$ 415,025

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

(13) Commercial mortgage loans totaling \$9.8 million at value were on non-accrual status and therefore were considered non-income producing.

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



## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF INVESTMENTS

Private Finance Portfolio Company (in thousands, except number of shares) Companies More Than 25% Owned	Investment <sup>(1)(2)</sup>	December 31, 2008		
		Principal	Cost	Value
AGILE Fund I, LLC <sup>(5)</sup>	Equity Interests		\$ 694	\$ 497
(Private Equity Fund)	<b>Total Investment</b>		<b>694</b>	<b>497</b>
AllBridge Financial, LLC	Equity Interests		33,294	10,960
(Asset Management)	<b>Total Investment</b>		<b>33,294</b>	<b>10,960</b>
	Standby Letter of Credit (\$15,000)			
Allied Capital Senior Debt Fund, L.P. <sup>(5)</sup>	Limited Partnership Interests		31,800	31,800
(Private Debt Fund)	<b>Total Investment</b>		<b>31,800</b>	<b>31,800</b>
Avborne, Inc. <sup>(7)</sup>	Preferred Stock (12,500 shares)			942
(Business Services)	Common Stock (27,500 shares)			
	<b>Total Investment</b>			<b>942</b>
Avborne Heavy Maintenance, Inc. <sup>(7)</sup>	Common Stock (2,750 shares)			
(Business Services)	<b>Total Investment</b>			
Aviation Properties Corporation	Common Stock (100 shares)		93	
(Business Services)	<b>Total Investment</b>		<b>93</b>	
	Standby Letters of Credit (\$1,000)			
Border Foods, Inc.	Senior Loan (12.6%, Due 12/09 3/12)	\$ 33,027	26,860	33,027
(Consumer Products)	Preferred Stock (100,000 shares)		12,721	11,851
	Common Stock (260,467 shares)		3,847	

	<b>Total Investment</b>		<b>43,428</b>	<b>44,878</b>
Calder Capital Partners, LLC <sup>(5)</sup> (Asset Management)	Senior Loan (10.5%, Due 5/09) <sup>(6)</sup> Equity Interests	4,496	4,496 2,453	953
	<b>Total Investment</b>		<b>6,949</b>	<b>953</b>
Callidus Capital Corporation (Asset Management)	Subordinated Debt (18.0%, Due 8/13 2/14) Common Stock (100 shares)	16,068	16,068	16,068 34,377
	<b>Total Investment</b>		<b>16,068</b>	<b>50,445</b>
	Guaranty (\$6,447)			

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- (2) Common stock, preferred stock, warrants, options, and equity interests are generally non-income producing and restricted.
- (5) Non-registered investment company.
- (6) Loan or debt security is on non-accrual status and therefore is considered non-income producing.
- (7) Avborne, Inc. and Avborne Heavy Maintenance, Inc. are affiliated companies.

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



## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

## Private Finance

## Portfolio Company

(in thousands, except number of shares)

	Investment <sup>(1)(2)</sup>	December 31, 2008		
		Principal	Cost	Value
Ciena Capital LLC	Senior Loan (5.5%, Due 3/09) <sup>(6)</sup>	\$ 319,031	\$ 319,031	\$ 104,883
(Financial Services)	Class B Equity Interests		119,436	
	Class C Equity Interests		109,301	
	<b>Total Investment</b>		<b>547,768</b>	<b>104,883</b>
	Guaranty (\$5,000 See Note 3)			
	Standby Letters of Credit (\$102,600 See Note 3)			
CitiPostal Inc.	Senior Loan (4.0%, Due 12/13)	692	681	681
(Business Services)	Unitranche Debt (12.0%, Due 12/13)	51,758	51,548	51,548
	Subordinated Debt (16.0%, Due 12/15)	9,114	9,114	9,114
	Common Stock (37,024 shares)		12,726	8,616
	<b>Total Investment</b>		<b>74,069</b>	<b>69,959</b>
Coverall North America, Inc.	Unitranche Debt (12.0%, Due 7/11)	32,035	31,948	31,948
(Business Services)	Subordinated Debt (15.0%, Due 7/11)	5,563	5,549	5,549
	Common Stock (763,333 shares)		14,361	17,968
	<b>Total Investment</b>		<b>51,858</b>	<b>55,465</b>
CR Holding, Inc.	Subordinated Debt (16.6%, Due 2/13) <sup>(6)</sup>	39,307	39,193	17,360
(Consumer Products)	Common Stock (32,090,696 shares)		28,744	
	<b>Total Investment</b>		<b>67,937</b>	<b>17,360</b>

Crescent Equity Corp. <sup>(8)</sup>	Senior Loan (10.0%, Due 1/09)	433	433	433
(Business Services)	Subordinated Debt (11.0%, Due 9/11 6/17)	22,312	22,247	14,283
	Subordinated Debt (11.0%, Due 1/12 9/12) <sup>(6)</sup>	10,097	10,072	4,331
	Common Stock (174 shares)		81,255	4,580
	<b>Total Investment</b>		<b>114,007</b>	<b>23,627</b>
	Guaranty (\$900)			
	Standby Letters of Credit (\$200)			
Direct Capital Corporation	Subordinated Debt (16.0%, Due 3/13) <sup>(6)</sup>	55,671	55,496	13,530
(Financial Services)	Common Stock (2,317,020 shares)		25,732	
	<b>Total Investment</b>		<b>81,228</b>	<b>13,530</b>
Financial Pacific Company	Subordinated Debt (17.4%, Due 2/12 8/12)	68,967	68,840	62,189
(Financial Services)	Preferred Stock (9,458 shares)		8,865	
	Common Stock (12,711 shares)		12,783	
	<b>Total Investment</b>		<b>90,488</b>	<b>62,189</b>

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- (2) Common stock, preferred stock, warrants, options, and equity interests are generally non-income producing and restricted.
- (6) Loan or debt security is on non-accrual status and therefore is considered non-income producing.
- (8) Crescent Equity Corp. holds investments in Crescent Hotels & Resorts, LLC and affiliates.

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

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

## Private Finance

## Portfolio Company

(in thousands, except number of shares)

	Investment <sup>(1)(2)</sup>	December 31, 2008		
		Principal	Cost	Value
ForeSite Towers, LLC	Equity Interest		\$	\$ 889
(Tower Leasing)	<b>Total Investment</b>			<b>889</b>
Global Communications, LLC	Senior Loan (10.0%, Due 9/02) <sup>(6)</sup>	\$ 1,335	1,335	1,335
(Business Services)	<b>Total Investment</b>		<b>1,335</b>	<b>1,335</b>
Hot Light Brands, Inc. (Retail)	Senior Loan (9.0%, Due 2/11) <sup>(6)</sup> Common Stock (93,500 shares)	30,522	30,522 5,151	13,678
	<b>Total Investment</b>		<b>35,673</b>	<b>13,678</b>
	Standby Letter of Credit (\$105)			
Hot Stuff Foods, LLC (Consumer Products)	Senior Loan (4.0%, Due 2/11-2/12) Subordinated Debt (12.4%, Due 8/12-2/13) <sup>(6)</sup> Common Stock (1,147,453 shares)	53,597 83,692	53,456 83,387 56,187	42,378
	<b>Total Investment</b>		<b>193,030</b>	<b>42,378</b>
Huddle House, Inc. (Retail)	Subordinated Debt (15.0%, Due 12/12) Common Stock (358,428 shares)	57,244	57,067 35,828	57,067 20,922
	<b>Total Investment</b>		<b>92,895</b>	<b>77,989</b>
IAT Equity, LLC and Affiliates d/b/a Industrial Air Tool (Industrial Products)	Subordinated Debt (9.0%, Due 6/14) Equity Interests	6,000	6,000 7,500	6,000 8,860
	<b>Total Investment</b>		<b>13,500</b>	<b>14,860</b>

Impact Innovations Group, LLC	Equity Interests in Affiliate			321
(Business Services)	<b>Total Investment</b>			<b>321</b>
Insight Pharmaceuticals Corporation	Subordinated Debt (15.0%, Due 9/12)	45,827	45,738	45,827
(Consumer Products)	Subordinated Debt (19.0%, Due 9/12) <sup>(6)</sup>	16,177	16,126	17,532
	Preferred Stock (25,000 shares)		25,000	4,068
	Common Stock (620,000 shares)		6,325	
	<b>Total Investment</b>		<b>93,189</b>	<b>67,427</b>
Jakel, Inc.	Subordinated Debt (15.5%, Due 3/08) <sup>(6)</sup>	748	748	374
(Industrial Products)	<b>Total Investment</b>		<b>748</b>	<b>374</b>
Knightsbridge CLO 2007-1 Ltd. <sup>(4)</sup>	Class E Notes (13.8%, Due 1/22)	18,700	18,700	14,866
(CLO)	Income Notes (14.9%) <sup>(11)</sup>		40,914	35,214
	<b>Total Investment</b>		<b>59,614</b>	<b>50,080</b>

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- (4) Non-U.S. company or principal place of business outside the U.S.
- (6) Loan or debt security is on non-accrual status and therefore is considered non-income producing.
- (11) Represents the effective interest yield earned on the cost basis of these preferred equity investments and income notes. The yield is included in interest income in the consolidated statement of operations.

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

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

## Private Finance

## Portfolio Company

(in thousands, except number of shares)

Knightsbridge CLO 2008-1 Ltd.<sup>(4)</sup>

(CLO)

Investment<sup>(1)(2)</sup>Class C Notes (9.3%, Due  
6/18)Class D Notes (10.3%, Due  
6/18)Class E Notes (6.8%, Due  
6/18)Income Notes (16.6%)<sup>(11)</sup>**Total Investment**

December 31, 2008

Principal

Cost

Value

\$ 12,800

\$ 12,800

\$ 12,800

8,000

8,000

8,000

13,200

10,573

10,573

21,315

21,315

**52,688****52,688**

MHF Logistical Solutions, Inc.

(Business Services)

Subordinated Debt (13.0%,  
Due 6/12 6/13<sup>9</sup>)Preferred Stock  
(10,000 shares)Common Stock (20,934  
shares)**Total Investment**

49,841

49,633

20,942

**70,575**

MVL Group, Inc.

(Business Services)

Senior Loan (12.0%, Due  
6/09 7/09)Subordinated Debt (14.5%,  
Due 6/09 7/09)Subordinated Debt (3.0%,  
Due 6/09)<sup>(6)</sup>Common Stock  
(560,716 shares)**Total Investment**

30,674

30,663

30,663

41,074

40,994

40,994

144

139

86

555

**72,351****71,743**

Old Orchard Brands, LLC

(Consumer Products)

Subordinated Debt (18.0%,  
Due 7/14)

Equity Interests

18,951

18,882

18,882

16,857

27,763

**Total Investment****35,739****46,645**

Penn Detroit Diesel Allison, LLC

37,984

37,869

37,869

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(Business Services)	Subordinated Debt (15.5%, Due 8/13) Equity Interests		18,873	21,100
	<b>Total Investment</b>		<b>56,742</b>	<b>58,969</b>
Service Champ, Inc. (Business Services)	Subordinated Debt (15.5%, Due 4/12) Common Stock (55,112 shares)	27,050	26,984	26,984
	<b>Total Investment</b>		<b>38,769</b>	<b>48,140</b>
Stag-Parkway, Inc. (Business Services)	Unitranche Debt (14.0%, Due 7/12) Common Stock (25,000 shares)	17,975	17,920	17,962
	<b>Total Investment</b>		<b>50,606</b>	<b>24,930</b>
Startec Equity, LLC (Telecommunications)	Equity Interests		211	332
	<b>Total Investment</b>		<b>211</b>	<b>332</b>
Senior Secured Loan Fund LLC (Private Debt Fund)	Subordinated Certificates (12.0%) Equity Interests		125,423	125,423
	<b>Total Investment</b>		<b>125,424</b>	<b>125,424</b>
Worldwide Express Operations, LLC (Business Services)	Subordinated Debt (14.0%, Due 2/14) <sup>(6)</sup> Equity Interests Warrants	2,865	2,722	2,032
	<b>Total Investment</b>		<b>14,250</b>	<b>2,032</b>
<b>Total companies more than 25% owned</b>			<b>\$ 2,167,020</b>	<b>\$ 1,187,722</b>

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

- (4) Non-U.S. company or principal place of business outside the U.S.
- (6) Loan or debt security is on non-accrual status and therefore is considered non-income producing.
- (11) Represents the effective interest yield earned on the cost basis of these preferred equity investments and income notes. The yield is included in interest income in the consolidated statement of operations.

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

**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)**

<b>Private Finance Portfolio Company (in thousands, except number of shares) Companies 5% to 25% Owned</b>	<b>Investment<sup>(1)(2)</sup></b>	<b>December 31, 2008</b>		
		<b>Principal</b>	<b>Cost</b>	<b>Value</b>
10 <sup>th</sup> Street, LLC  (Business Services)	Subordinated Debt (13.0%, Due 11/14) Equity Interests Option	\$ 21,439	\$ 21,329 422 25	\$ 21,439 975 25
	<b>Total Investment</b>		<b>21,776</b>	<b>22,439</b>
Advantage Sales & Marketing, Inc.  (Business Services)	Subordinated Debt (12.0%, Due 3/14) Equity Interests	158,617	158,132	135,000 5,000
	<b>Total Investment</b>		<b>158,132</b>	<b>140,000</b>
Air Medical Group Holdings LLC (Healthcare Services)	Senior Loan (3.3%, Due 3/11) Equity Interests	3,360	3,326 2,993	3,139 10,800
	<b>Total Investment</b>		<b>6,319</b>	<b>13,939</b>
Alpine ESP Holdings, Inc. (Business Services)	Preferred Stock (701 shares) Common Stock (11,657 shares)		701 13	
	<b>Total Investment</b>		<b>714</b>	
Amerex Group, LLC  (Consumer Products)	Subordinated Debt (12.3%, Due 1/13) Equity Interests	8,789	8,784 3,508	8,784 9,932
	<b>Total Investment</b>		<b>12,292</b>	<b>18,716</b>
BB&T Capital Partners/Windsor Mezzanine Fund, LLC <sup>(5)</sup> (Private Equity Fund)	Equity Interests		11,789	11,063
	<b>Total Investment</b>		<b>11,789</b>	<b>11,063</b>



Becker Underwood, Inc. (Industrial Products)	Subordinated Debt (14.5%, Due 8/12) Common Stock (4,376 shares)	25,503	25,450 5,014	25,502 2,267
	<b>Total Investment</b>		<b>30,464</b>	<b>27,769</b>
Drew Foam Companies, Inc. (Business Services)	Preferred Stock (622,555 shares) Common Stock (6,286 shares)		623 6	512
	<b>Total Investment</b>		<b>629</b>	<b>512</b>
Driven Brands, Inc. (Consumer Services)	Subordinated Debt (16.5%, Due 7/15) Common Stock (3,772,098 shares)	84,106	83,698 9,516	83,698 4,855
	<b>Total Investment</b>		<b>93,214</b>	<b>88,553</b>
Hilden America, Inc. (Consumer Products)	Common Stock (19 shares)		454	76
	<b>Total Investment</b>		<b>454</b>	<b>76</b>
Lydall Transport, Ltd. (Business Services)	Equity Interests		432	345
	<b>Total Investment</b>		<b>432</b>	<b>345</b>
Multi-Ad Services, Inc. (Business Services)	Unitranche Debt (11.3%, Due 11/11) Equity Interests	3,018	2,995 1,737	2,941 1,782
	<b>Total Investment</b>		<b>4,732</b>	<b>4,723</b>

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- (2) Common stock, preferred stock, warrants, options, and equity interests are generally non-income producing and restricted.
- (5) Non-registered investment company.

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



**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)**

<b>Private Finance</b>		<b>December 31, 2008</b>		
<b>Portfolio Company</b>	<b>Investment<sup>(1)(2)</sup></b>	<b>Principal</b>	<b>Cost</b>	<b>Value</b>
<b>(in thousands, except number of shares)</b>				
Progressive International Corporation (Consumer Products)	Preferred Stock (500 shares) Common Stock (197 shares) Warrants		\$ 500 13	\$ 1,125 4,600
	<b>Total Investment</b>		<b>513</b>	<b>5,725</b>
Regency Healthcare Group, LLC (Healthcare Services)	Unitranche Debt (11.1%, Due 6/12) Equity Interests	\$ 10,901	10,855 1,302	10,825 2,050
	<b>Total Investment</b>		<b>12,157</b>	<b>12,875</b>
SGT India Private Limited <sup>(4)</sup> (Business Services)	Common Stock (150,596 shares)		4,137	
	<b>Total Investment</b>		<b>4,137</b>	
Soteria Imaging Services, LLC (Healthcare Services)	Subordinated Debt (11.3%, Due 11/10) Equity Interests	4,250	4,167 1,881	4,054 1,971
	<b>Total Investment</b>		<b>6,048</b>	<b>6,025</b>
Triax Holdings, LLC (Consumer Products)	Subordinated Debt (21.0%, Due 2/12) <sup>(6)</sup> Equity Interests	10,625	10,587 16,528	
	<b>Total Investment</b>		<b>27,115</b>	
Universal Environmental Services, LLC (Business Services)	Equity Interests		1,599	
	<b>Total Investment</b>		<b>1,599</b>	
<b>Total companies 5% to 25% owned</b>			<b>\$ 392,516</b>	<b>\$ 352,760</b>

**Companies Less Than 5% Owned**

3SI Security Systems, Inc.	Subordinated Debt (14.6%, Due 8/13)	\$ 29,200	\$ 29,118	\$ 28,170
(Consumer Products)	<b>Total Investment</b>		<b>29,118</b>	<b>28,170</b>
Abraxas Corporation	Subordinated Debt (14.6%, Due 4/13)	36,822	36,662	36,170
(Business Services)	<b>Total Investment</b>		<b>36,662</b>	<b>36,170</b>
Augusta Sportswear Group, Inc.	Subordinated Debt (13.0%, Due 1/15)	53,000	52,825	52,406
(Consumer Products)	Common Stock (2,500 shares)		2,500	1,400
	<b>Total Investment</b>		<b>55,325</b>	<b>53,806</b>
Axium Healthcare Pharmacy, Inc.	Senior Loan (14.0%, Due 12/12)	3,750	3,724	3,654
(Healthcare Services)	Unitranche Debt (14.0%, Due 12/12)	8,500	8,471	7,908
	Common Stock (22,860 shares)		2,286	100
	<b>Total Investment</b>		<b>14,481</b>	<b>11,662</b>

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- (4) Non-U.S. company or principal place of business outside the U.S.
- (6) Loan or debt security is on non-accrual status and therefore is considered non-income producing.

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## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

## Private Finance

## Portfolio Company

(in thousands, except number of shares)

Baird Capital Partners IV Limited<sup>(5)</sup>Investment<sup>(1)(2)</sup>

Limited Partnership Interest

December 31, 2008

Principal

Cost

Value

\$ 3,636 \$ 2,978

(Private Equity Fund)

**Total Investment****3,636****2,978**

BenefitMall Holdings Inc.

Subordinated Debt (18.0%,  
Due 6/14)

\$ 40,326

40,238

40,238

(Business Services)

Common Stock (39,274,290  
shares)<sup>(12)</sup>

39,274

91,149

Warrants<sup>(12)</sup>**Total Investment****79,512****131,387**

Broadcast Electronics, Inc.

Senior Loan (8.8%, Due  
11/11)<sup>(6)</sup>

4,912

4,884

773

(Business Services)

Preferred Stock (2,044 shares)

**Total Investment****4,884****773**

Bushnell, Inc.

Subordinated Debt (8.0%,  
Due 2/14)

41,325

40,003

35,794

(Consumer Products)

**Total Investment****40,003****35,794**

Callidus Debt Partners

Class C Notes (12.9%, Due  
12/13)

18,800

18,907

10,116

CDO Fund I, Ltd.<sup>(4)(10)</sup>Class D Notes (17.0%, Due  
12/13)

9,400

9,454

(CDO)

**Total Investment****28,361****10,116**

Callidus Debt Partners

Preferred Shares (23,600,000  
shares)

20,138

5,402

CLO Fund III, Ltd.<sup>(4)(10)</sup>

(CLO)

**Total Investment****20,138****5,402**

Callidus Debt Partners	Class D Notes (9.1%, Due 4/20)	3,000	2,045	1,445
CLO Fund IV, Ltd. <sup>(4)(10)</sup> (CLO)	Income Notes (13.2%) <sup>(11)</sup>		14,591	10,628
	<b>Total Investment</b>		<b>16,636</b>	<b>12,073</b>
Callidus Debt Partners	Income Notes (16.4%) <sup>(11)</sup>		13,388	10,331
CLO Fund V, Ltd. <sup>(4)(10)</sup> (CLO)				
	<b>Total Investment</b>		<b>13,388</b>	<b>10,331</b>
Callidus Debt Partners	Class D Notes (9.8%, Due 10/21)	9,000	7,144	3,929
CLO Fund VI, Ltd. <sup>(4)(10)</sup> (CLO)	Income Notes (17.8%) <sup>(11)</sup>		28,314	23,090
	<b>Total Investment</b>		<b>35,458</b>	<b>27,019</b>
Callidus Debt Partners	Income Notes (11.4%) <sup>(11)</sup>		24,026	15,361
CLO Fund VII, Ltd. <sup>(4)(10)</sup> (CLO)				
	<b>Total Investment</b>		<b>24,026</b>	<b>15,361</b>

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**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)**

**Private Finance****Portfolio Company****(in thousands, except number of shares)**

		<b>December 31, 2008</b>		
	<b>Investment<sup>(1)(2)</sup></b>	<b>Principal</b>	<b>Cost</b>	<b>Value</b>
Callidus MAPS CLO Fund I LLC <sup>(10)</sup> (CLO)	Class E Notes (7.0%, Due 12/17)	\$ 17,000	\$ 17,000	\$ 9,813
	Income Notes (4.0%) <sup>(11)</sup>		45,053	27,678
	<b>Total Investment</b>		<b>62,053</b>	<b>37,491</b>
Callidus MAPS CLO Fund II, Ltd. <sup>(4)(10)</sup>  (CLO)	Class D Notes (8.8%, Due 7/22)	7,700	3,555	2,948
	Income Notes (13.3%) <sup>(11)</sup>		18,393	12,626
	<b>Total Investment</b>		<b>21,948</b>	<b>15,574</b>
Carlisle Wide Plank Floors, Inc. (Consumer Products)	Senior Loan (6.1%, Due 6/11)	1,000	998	953
	Unitranche Debt (14.5%, Due 6/11)	3,161	3,139	3,047
	Preferred Stock (345,056 Shares)		345	82
	<b>Total Investment</b>		<b>4,482</b>	<b>4,082</b>
Catterton Partners VI, L.P. <sup>(5)</sup>  (Private Equity Fund)	Limited Partnership Interest		2,812	2,356
	<b>Total Investment</b>		<b>2,812</b>	<b>2,356</b>
Centre Capital Investors V, L.P. <sup>(5)</sup>  (Private Equity Fund)	Limited Partnership Interest		3,049	2,344
	<b>Total Investment</b>		<b>3,049</b>	<b>2,344</b>
CK Franchising, Inc. (Consumer Services)	Subordinated Debt (12.3%, Due 7/12 7/17)	21,000	20,912	20,912
	Preferred Stock (1,281,887 shares)		1,282	1,592
	Common Stock (7,585,549 shares)		7,586	10,600
	<b>Total Investment</b>		<b>29,780</b>	<b>33,104</b>
Commercial Credit Group, Inc.		19,000	18,970	18,970

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(Financial Services)	Subordinated Debt (15.0%, Due 6/15) Preferred Stock (64,679 shares) Warrants		15,543	9,073
	<b>Total Investment</b>		<b>34,513</b>	<b>28,043</b>
Community Education Centers, Inc.	Subordinated Debt (14.5%, Due 11/13)	35,548	35,486	34,056
(Education Services)	<b>Total Investment</b>		<b>35,486</b>	<b>34,056</b>
Component Hardware Group, Inc.	Subordinated Debt (13.5%, Due 1/13)	18,710	18,654	18,261
(Industrial Products)	<b>Total Investment</b>		<b>18,654</b>	<b>18,261</b>
Cook Inlet Alternative Risk, LLC	Unitranche Debt (10.8%, Due 4/13)	90,000	89,619	82,839
(Business Services)	Equity Interests		552	
	<b>Total Investment</b>		<b>90,171</b>	<b>82,839</b>
Cortec Group Fund IV, L.P. <sup>(5)</sup>	Limited Partnership Interest		4,647	3,445
(Private Equity)	<b>Total Investment</b>		<b>4,647</b>	<b>3,445</b>

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## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

## Private Finance

## Portfolio Company

(in thousands, except number of shares)	Investment <sup>(1)(2)</sup>	December 31, 2008		
		Principal	Cost	Value
Diversified Mercury Communications, LLC (Business Services)	Senior Loan (4.5%, Due 3/13)	\$ 2,972	\$ 2,958	\$ 2,692
	<b>Total Investment</b>		<b>2,958</b>	<b>2,692</b>
Digital VideoStream, LLC (Business Services)	Unitranche Debt (11.0%, Due 2/12)	14,097	14,032	14,003
	Convertible Subordinated Debt (10.0%, Due 2/16)	4,545	4,533	4,700
	<b>Total Investment</b>		<b>18,565</b>	<b>18,703</b>
DirectBuy Holdings, Inc. (Consumer Products)	Subordinated Debt (14.5%, Due 5/13)	75,909	75,609	71,703
	Equity Interests		8,000	3,200
	<b>Total Investment</b>		<b>83,609</b>	<b>74,903</b>
Distant Lands Trading Co. (Consumer Products)	Senior Loan (7.5%, Due 11/11)	4,825	4,800	4,501
	Unitranche Debt (12.3%, Due 11/11)	43,133	43,022	42,340
	Common Stock (3,451 shares)		3,451	984
	<b>Total Investment</b>		<b>51,273</b>	<b>47,825</b>
Dryden XVIII Leveraged Loan 2007 Limited <sup>(4)</sup> (CLO)	Class B Notes (8.0%, Due 10/19)	9,000	7,728	4,535
	Income Notes (16.0%) <sup>(11)</sup>		22,080	17,477
	<b>Total Investment</b>		<b>29,808</b>	<b>22,012</b>
Dynamic India Fund IV <sup>(4)(5)</sup> (Private Equity Fund)	Equity Interests		9,350	8,966
	<b>Total Investment</b>		<b>9,350</b>	<b>8,966</b>
EarthColor, Inc.		123,819	123,385	77,243

(Business Services)	Subordinated Debt (15.0%, Due 11/13) <sup>(6)</sup> Common Stock (63,438 shares) <sup>(12)</sup> Warrants <sup>(12)</sup>		63,438	
	<b>Total Investment</b>		<b>186,823</b>	<b>77,243</b>
eCentury Capital Partners, L.P. <sup>(5)</sup>	Limited Partnership Interest		7,274	1,431
(Private Equity Fund)	<b>Total Investment</b>		<b>7,274</b>	<b>1,431</b>
eInstruction Corporation	Subordinated Debt (12.6%, Due 7/14-1/15)	33,931	33,795	31,670
(Education Services)	Common Stock (2,406 shares)		2,500	1,700
	<b>Total Investment</b>		<b>36,295</b>	<b>33,370</b>
Farley s & Sathers Candy Company, Inc.	Subordinated Debt (10.1%, Due 3/11)	2,500	2,493	2,365
(Consumer Products)	<b>Total Investment</b>		<b>2,493</b>	<b>2,365</b>

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## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

## Private Finance

## Portfolio Company

(in thousands, except number of shares)

	Investment <sup>(1)(2)</sup>	December 31, 2008		
		Principal	Cost	Value
FCP-BHI Holdings, LLC	Subordinated Debt (12.0%, Due 9/13)	\$ 27,284	\$ 27,191	\$ 25,640
d/b/a Bojangles	Equity Interests		1,029	1,700
(Retail)	<b>Total Investment</b>		<b>28,220</b>	<b>27,340</b>
Fidus Mezzanine Capital, L.P. <sup>(5)</sup>	Limited Partnership Interest		9,597	6,754
(Private Equity Fund)	<b>Total Investment</b>		<b>9,597</b>	<b>6,754</b>
Freedom Financial Network, LLC	Subordinated Debt (13.5%, Due 2/14)	13,000	12,945	12,811
(Financial Services)	<b>Total Investment</b>		<b>12,945</b>	<b>12,811</b>
Geotrace Technologies, Inc.	Warrants		2,027	3,000
(Energy Services)	<b>Total Investment</b>		<b>2,027</b>	<b>3,000</b>
Gilchrist & Soames, Inc. (Consumer Products)	Subordinated Debt (13.4%, Due 10/13)	25,800	25,660	24,692
	<b>Total Investment</b>		<b>25,660</b>	<b>24,692</b>
Havco Wood Products LLC	Equity Interests		910	400
(Industrial Products)	<b>Total Investment</b>		<b>910</b>	<b>400</b>
Higginbotham Insurance Agency, Inc.	Subordinated Debt (13.7%, Due 8/13 8/14)	53,305	53,088	53,088
(Business Services)	Common Stock (23,695 shares) <sup>(12)</sup> Warrant <sup>(12)</sup>		23,695	27,335
	<b>Total Investment</b>		<b>76,783</b>	<b>80,423</b>

The Hillman Companies, Inc. <sup>(3)</sup>	Subordinated Debt (10.0%, Due 9/11)	44,580	44,491	44,345
(Consumer Products)	<b>Total Investment</b>		<b>44,491</b>	<b>44,345</b>
The Homax Group, Inc.	Senior Loan (7.2%, Due 10/12)	11,785	11,742	10,689
(Consumer Products)	Subordinated Debt (14.5%, Due 4/14)	14,000	13,371	12,859
	Preferred Stock (76 shares)		76	
	Common Stock (24 shares)		5	
	Warrants		954	
	<b>Total Investment</b>		<b>26,148</b>	<b>23,548</b>
Ideal Snacks Corporation	Senior Loan (5.3%, Due 6/10)	1,496	1,496	1,438
(Consumer Products)	<b>Total Investment</b>		<b>1,496</b>	<b>1,438</b>

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## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

## Private Finance

## Portfolio Company

(in thousands, except number of shares)

	Investment <sup>(1)(2)</sup>	December 31, 2008		
		Principal	Cost	Value
Kodiak Fund LP <sup>(5)</sup>	Equity Interests		\$ 9,422	\$ 900
(Private Equity Fund)	<b>Total Investment</b>		<b>9,422</b>	<b>900</b>
Market Track Holdings, LLC (Business Services)	Senior Loan (8.0%, Due 6/14)	\$ 2,500	2,450	2,352
	Subordinated Debt (15.9%, Due 6/14)	24,600	24,488	23,785
	<b>Total Investment</b>		<b>26,938</b>	<b>26,137</b>
NetShape Technologies, Inc.	Senior Loan (5.3%, Due 2/13)	382	382	346
(Industrial Products)	<b>Total Investment</b>		<b>382</b>	<b>346</b>
Network Hardware Resale, Inc. (Business Services)	Unitranche Debt (12.5%, Due 12/11)	18,734	18,809	18,703
	Convertible Subordinated Debt (9.8%, Due 12/15)	14,533	14,585	14,585
	<b>Total Investment</b>		<b>33,394</b>	<b>33,288</b>
Novak Biddle Venture Partners III, L.P. <sup>(5)</sup>	Limited Partnership Interest		2,018	1,349
(Private Equity Fund)	<b>Total Investment</b>		<b>2,018</b>	<b>1,349</b>
Oahu Waste Services, Inc. (Business Services)	Stock Appreciation Rights		206	750
	<b>Total Investment</b>		<b>206</b>	<b>750</b>
Pangaea CLO 2007-1 Ltd. <sup>(4)</sup>	Class D Notes (9.2%, Due 10/21)	15,000	11,761	7,114
(CLO)	<b>Total Investment</b>		<b>11,761</b>	<b>7,114</b>

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PC Helps Support, LLC (Business Services)	Senior Loan (4.8%, Due 12/13)	8,610	8,520	8,587
	Subordinated Debt (13.3%, Due 12/13)	28,136	28,009	28,974
	<b>Total Investment</b>		<b>36,529</b>	<b>37,561</b>
Performant Financial Corporation (Business Services)	Common Stock (478,816 shares)		734	200
	<b>Total Investment</b>		<b>734</b>	<b>200</b>

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**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)**

<b>Private Finance</b>		<b>December 31, 2008</b>		
<b>Portfolio Company</b>	<b>Investment<sup>(1)(2)</sup></b>	<b>Principal</b>	<b>Cost</b>	<b>Value</b>
<b>(in thousands, except number of shares)</b>			<b>\$</b>	<b>\$</b>
Peter Brasseler Holdings, LLC	Equity Interests		\$ 3,451	\$ 2,900
(Business Services)	<b>Total Investment</b>		<b>3,451</b>	<b>2,900</b>
PharMEDium Healthcare Corporation	Senior Loan (4.3%, Due 10/13)	\$ 1,910	1,910	1,747
(Healthcare Services)	<b>Total Investment</b>		<b>1,910</b>	<b>1,747</b>
Postle Aluminum Company, LLC	Unitranche Debt (13.0%, Due 10/12) <sup>(6)</sup>	58,953	58,744	9,978
(Industrial Products)	Equity Interests		2,174	
	<b>Total Investment</b>		<b>60,918</b>	<b>9,978</b>
Pro Mach, Inc.	Subordinated Debt (12.5%, Due 6/12)	14,616	14,573	14,089
(Industrial Products)	Equity Interests		1,294	1,900
	<b>Total Investment</b>		<b>15,867</b>	<b>15,989</b>
Promo Works, LLC	Unitranche Debt (12.3%, Due 12/11)	23,111	22,954	21,266
(Business Services)	<b>Total Investment</b>		<b>22,954</b>	<b>21,266</b>
Reed Group, Ltd.	Senior Loan (7.6%, Due 12/13)	12,893	12,758	11,502
(Healthcare Services)	Subordinated Debt (13.8%, Due 12/13)	18,543	18,469	16,683
	Equity Interests		1,800	300
	<b>Total Investment</b>		<b>33,027</b>	<b>28,485</b>
S.B. Restaurant Company	Unitranche Debt (9.8%, Due 4/11)	36,501	36,295	34,914
(Retail)	Preferred Stock (46,690 shares)		117	117

	Warrants		534	
	<b>Total Investment</b>		<b>36,946</b>	<b>35,031</b>
	Standby Letters of Credit (\$2,465)			
Snow Phipps Group, L.P. <sup>(5)</sup>	Limited Partnership Interest		4,785	4,374
(Private Equity Fund)	<b>Total Investment</b>		<b>4,785</b>	<b>4,374</b>
SPP Mezzanine Funding II, L.P. <sup>(5)</sup>	Limited Partnership Interest		9,362	9,269
(Private Equity Fund)	<b>Total Investment</b>		<b>9,362</b>	<b>9,269</b>
STS Operating, Inc.	Subordinated Debt (11.0%, Due 1/13)	30,386	30,296	29,745
(Industrial Products)	<b>Total Investment</b>		<b>30,296</b>	<b>29,745</b>
Summit Energy Services, Inc. (Business Services)	Subordinated Debt (11.6%, Due 8/13) Common Stock (415,982 shares)	35,730	35,547 1,861	32,113 1,900
	<b>Total Investment</b>		<b>37,408</b>	<b>34,013</b>
Tank Intermediate Holding Corp. (Industrial Products)	Senior Loan (7.1%, Due 9/14)	30,514	29,539	25,937
	<b>Total Investment</b>		<b>29,539</b>	<b>25,937</b>

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## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

## Private Finance

## Portfolio Company

(in thousands, except number of shares)

	Investment <sup>(1)(2)</sup>	Principal	December 31, 2008		Value
			Cost		
Tappan Wire & Cable Inc.	Unitranche Debt (15.0%, Due 8/14)	\$ 22,346	\$ 22,248	\$	15,625
(Business Services)	Common Stock (12,940 shares) <sup>(12)</sup>		2,043		
	Warrant <sup>(12)</sup>				
	<b>Total Investment</b>		<b>24,291</b>		<b>15,625</b>
The Step2 Company, LLC	Unitranche Debt (11.0%, Due 4/12)	95,083	94,816		90,474
(Consumer Products)	Equity Interests		2,156		1,161
	<b>Total Investment</b>		<b>96,972</b>		<b>91,635</b>
Tradesmen International, Inc.	Subordinated Debt (12.0%, Due 12/12)	40,000	39,586		37,840
(Business Services)	<b>Total Investment</b>		<b>39,586</b>		<b>37,840</b>
TransAmerican Auto Parts, LLC	Subordinated Debt (16.3%, Due 11/12) <sup>(6)</sup>	24,561	24,409		
(Consumer Products)	Equity Interests		1,034		
	<b>Total Investment</b>		<b>25,443</b>		
Trover Solutions, Inc.	Subordinated Debt (12.0%, Due 11/12)	60,054	59,847		57,362
(Business Services)	<b>Total Investment</b>		<b>59,847</b>		<b>57,362</b>
United Road Towing, Inc.	Subordinated Debt (12.1%, Due 1/14)	20,000	19,915		20,000
(Consumer Services)	<b>Total Investment</b>		<b>19,915</b>		<b>20,000</b>

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Venturehouse-Cibernet Investors, LLC	Equity Interest			
(Business Services)	<b>Total Investment</b>			
VICORP Restaurants, Inc.	Warrants		33	
(Retail)	<b>Total Investment</b>		<b>33</b>	
WMA Equity Corporation and Affiliates	Subordinated Debt (16.8%, Due 4/13-4/14) <sup>(6)</sup>	139,455	138,559	63,823
d/b/a Wear Me Apparel	Common Stock (86 shares)		39,721	
(Consumer Products)	<b>Total Investment</b>		<b>178,280</b>	<b>63,823</b>
Webster Capital II, L.P. <sup>(5)</sup>	Limited Partnership Interest		1,702	1,481
(Private Equity Fund)	<b>Total Investment</b>		<b>1,702</b>	<b>1,481</b>
Woodstream Corporation	Subordinated Debt (12.0%, Due 2/15)	90,000	89,633	83,258
(Consumer Products)	Common Stock (6,960 shares)		6,961	2,500
	<b>Total Investment</b>		<b>96,594</b>	<b>85,758</b>
York Insurance Services Group, Inc.	Common Stock (12,939 shares)		1,294	1,700
(Business Services)	<b>Total Investment</b>		<b>1,294</b>	<b>1,700</b>
Other companies	Other debt investments	155	74	72
	Other equity investments		30	8
	<b>Total Investment</b>		<b>104</b>	<b>80</b>
<b>Total companies less than 5% owned</b>			<b>\$ 2,317,856</b>	<b>\$ 1,858,581</b>
<b>Total private finance (138 portfolio investments)</b>			<b>\$ 4,877,392</b>	<b>\$ 3,399,063</b>

- (1) Interest rates represent the weighted average annual stated interest rate on loans and debt securities, which are presented by nature of indebtedness for a single issuer. The maturity dates represent the earliest and the latest maturity dates.
- (2) Common stock, preferred stock, warrants, options, and equity interests are generally non-income producing and restricted.
- (5) Non-registered investment company.
- (6) Loan or debt security is on non-accrual status and therefore is considered non-income producing.
- (12) Common stock is non-voting. In addition to non-voting stock ownership, the Company has an option to acquire a majority of the voting securities of the portfolio company at fair market value.

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

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

Commercial Real Estate Finance  
(in thousands, except number of loans)

	Stated Interest Rate Ranges	Number of Loans	December 31, 2008	
			Cost	Value
<b>Commercial Mortgage Loans</b>				
	Up to 6.99%	4	\$ 30,999	\$ 30,537
	7.00% 8.99%	1	644	580
	9.00% 10.99%	1	6,465	6,465
	11.00% 12.99%	1	10,469	9,391
	15.00% and above	2	3,970	6,529
<b>Total commercial mortgage loans<sup>(13)</sup></b>			<b>\$ 52,547</b>	<b>\$ 53,502</b>
<b>Real Estate Owned</b>			<b>\$ 18,201</b>	<b>\$ 20,823</b>
<b>Equity Interests<sup>(2)</sup> Companies more than 25% owned</b>			<b>\$ 14,755</b>	<b>\$ 19,562</b>
Guarantees (\$6,871)				
Standby Letter of Credit (\$650)				
<b>Total commercial real estate finance</b>			<b>\$ 85,503</b>	<b>\$ 93,887</b>
<b>Total portfolio</b>			<b>\$ 4,962,895</b>	<b>\$ 3,492,950</b>

	Yield	Cost	Value
<b>Investments in Money Market and Other Securities</b>			
SEI Daily Income Tr Prime Obligation Money Market Fund	0.9%	\$ 5	\$ 5
Columbia Treasury Reserves Fund		12	12
Other Money Market Funds		270	270
Total		\$ 287	\$ 287

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

(13) Commercial mortgage loans totaling \$7.7 million at value were on non-accrual status and therefore were considered non-income producing.

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



**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Information at and for the three and six months ended June 30, 2009 and 2008 is unaudited)**

**Note 1. Organization**

Allied Capital Corporation, a Maryland corporation, is a closed-end, non-diversified management investment company that has elected to be regulated as a business development company ( BDC ) under the Investment Company Act of 1940 ( 1940 Act ). Allied Capital Corporation ( ACC ) has a real estate investment trust subsidiary, Allied Capital REIT, Inc. ( Allied REIT ), and several subsidiaries that are single member limited liability companies established for specific purposes including holding real estate properties. ACC also has a subsidiary, A.C. Corporation ( AC Corp ), that generally provides diligence and structuring services, as well as transaction, management, consulting, and other services, including underwriting and arranging senior loans, to the Company, its portfolio companies and its managed funds.

ACC and its subsidiaries, collectively, are referred to as the Company. The Company consolidates the results of its subsidiaries for financial reporting purposes.

Pursuant to Article 6 of Regulation S-X, the financial results of the Company's portfolio investments are not consolidated in the Company's financial statements. Portfolio investments are held for purposes of deriving investment income and future capital gains.

The investment objective of the Company is to achieve current income and capital gains. In order to achieve this objective, the Company has primarily invested in debt and equity securities of private companies in a variety of industries.

***Events of Default, Liquidity and Operations***

Beginning in the second half of 2008, the Company has experienced a significant reduction in its net worth, primarily resulting from net unrealized depreciation on its portfolio, which has reflected market conditions. As a result, on December 30, 2008, the Company entered into amendments relating to its private notes and revolving line of credit, including amendments which added new covenants. The amendments are more fully described in Note 4 to the consolidated financial statements.

In January 2009 the Company re-opened discussions with the revolving line of credit lenders (the Lenders ) and the private noteholders (the Noteholders ) to seek relief under certain terms of both the revolving credit facility and the private notes due to a then-expected covenant default. As of December 31, 2008, the Company's asset coverage was less than the 200% required by the revolving credit facility and the private notes, and as of June 30, 2009, the Company's asset coverage remained less than 200%. Asset coverage generally refers to the percentage resulting from assets less accounts payable and other liabilities, divided by total debt. In addition, the Company has not completed the documents contemplated by the December 30, 2008 amendments to the revolving credit facility and private notes, which were to include a grant of a first lien security interest on substantially all of the Company's assets. Under the revolving credit facility and the private notes, events of default have occurred and are continuing related to these covenants and certain financial and other covenants.

The existence of an event of default under the revolving credit facility and private notes restricts the Company from additional borrowing or obtaining letters of credit under its revolving credit facility, and from declaring dividends or

other distributions to the Company's shareholders. Pursuant to the terms of the revolving credit facility, during the continuance of an event of default, the applicable spread on any borrowings outstanding and fees on any letters of credit outstanding under the revolving credit facility increase by up to 200 basis points. Pursuant to the terms of the private notes, during the continuance of an event of default, the rate of interest borne by the private notes increases by 200 basis points.

On March 27, 2009, pursuant to the terms of the revolving line of credit, the administrative agent for the lenders terminated substantially all of the unused commitments under the revolving line of credit. As a result, the aggregate commitments under the Company's revolving line of credit were reduced to

**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 1. Organization, continued**

\$165.0 million. As of June 30, 2009, the Company had \$50 million in outstanding borrowings and \$62.0 million in outstanding letters of credit issued under the revolving line of credit. Subsequent to June 30, 2009, the aggregate commitments under the revolving line of credit were reduced to \$115.0 million.

Neither the Lenders nor the Noteholders have accelerated repayment of the Company's obligations; however, the occurrence of an event of default permits the administrative agent for the Lenders, or the holders of more than 51% of the commitments under the revolving credit facility, to accelerate repayment of all amounts due, to terminate commitments thereunder, and to require the Company to provide cash collateral equal to the face amount of all outstanding letters of credit. Pursuant to the terms of the private notes, the occurrence of an event of default permits the holders of 51% or more of any issue of outstanding private notes to accelerate repayment of all amounts due thereunder.

In July 2009, the Company agreed in principle to terms with the Lenders and the Noteholders on a comprehensive restructuring of these debt agreements. In connection with these restructuring discussions, the Company repaid \$100 million of the outstanding private notes in the third quarter of 2009. The terms of the restructuring are non-binding and remain subject to final documentation and closure. There can be no assurance of the timing of any debt restructuring or that the Company will complete a restructuring of its debt. Until the restructuring is completed, this debt remains subject to acceleration. The Company expects the restructured debt to result in a significantly increased cost of capital, including significant fees at closing. As a result, the Company expects its profitability will be substantially reduced and that it would not be able to pay a cash dividend for an extended period of time.

Pursuant to the 1940 Act, the Company is not permitted to issue indebtedness unless immediately after such issuance the Company has asset coverage of all outstanding indebtedness of at least 200%. The Company's publicly issued unsecured notes payable require the Company to comply with this provision of the 1940 Act. At June 30, 2009, the Company's asset coverage ratio was 174%, which is less than the 200% requirement. As a result under the publicly issued unsecured notes payable, the Company will not be able to issue additional indebtedness until such time as its asset coverage returns to at least 200%. The Company has not experienced any default or cross default with respect to the publicly issued unsecured notes payable.

The Company's consolidated financial statements have been prepared assuming that the Company will continue as a going concern. The Company does not have available cash resources sufficient to satisfy all of the obligations under the revolving credit facility and the private notes should the lenders accelerate these obligations. These factors raise substantial doubt about the Company's ability to continue as a going concern. In addition, the Company continues to sell assets to generate capital to repay debt. There can be no assurance that the Company's plans will be successful in addressing the liquidity uncertainties discussed above. In the event there is an acceleration of the amounts outstanding under the revolving credit facility or any issue of the private notes, it would cause the Company to evaluate other alternatives and would have a material adverse effect on the Company's operations. The accompanying consolidated financial statements do not include any adjustments that might result from these uncertainties.

**Note 2. Summary of Significant Accounting Policies**

*Basis of Presentation*



The consolidated financial statements include the accounts of ACC and its subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation. Certain reclassifications have been made to the 2008 balances to conform with the 2009 financial statement presentation.

**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 2. Summary of Significant Accounting Policies, continued**

The accompanying unaudited consolidated financial statements of the Company have been prepared in accordance with U.S. generally accepted accounting principles ( GAAP ) for interim financial information. Accordingly, they do not include all of the information and footnotes required by GAAP for complete consolidated financial statements. In the opinion of management, the unaudited consolidated financial results of the Company included herein contain all adjustments (consisting of only normal recurring accruals) necessary to present fairly the financial position of the Company as of June 30, 2009, the results of operations for the three and six months ended June 30, 2009 and 2008, and changes in net assets and cash flows for the six months ended June 30, 2009 and 2008. The results of operations for the three and six months ended June 30, 2009, are not necessarily indicative of the operating results to be expected for the full year.

The private finance portfolio and the interest and related portfolio income and net realized gains (losses) on the private finance portfolio are presented in three categories: companies more than 25% owned, which represent portfolio companies where the Company directly or indirectly owns more than 25% of the outstanding voting securities of such portfolio company or where the Company controls the portfolio company's board of directors and, therefore, are deemed controlled by the Company under the 1940 Act; companies owned 5% to 25%, which represent portfolio companies where the Company directly or indirectly owns 5% to 25% of the outstanding voting securities of such portfolio company or where the Company holds one or more seats on the portfolio company's board of directors and, therefore, are deemed to be an affiliated person under the 1940 Act; and companies less than 5% owned which represent portfolio companies where the Company directly or indirectly owns less than 5% of the outstanding voting securities of such portfolio company and where the Company has no other affiliations with such portfolio company. The interest and related portfolio income and net realized gains (losses) from the commercial real estate finance portfolio and other sources, including investments in money market and other securities, are included in the companies less than 5% owned category on the consolidated statement of operations.

In the ordinary course of business, the Company enters into transactions with portfolio companies that may be considered related party transactions.

The Company, as a BDC, has invested in illiquid securities including debt and equity securities of portfolio companies, CLO bonds and preferred shares/income notes, CDO bonds and investment funds. The Company's investments may be subject to certain restrictions on resale and generally have no established trading market. The Company values substantially all of its investments at fair value as determined in good faith by the Board of Directors in accordance with the Company's valuation policy and the provisions of the 1940 Act and FASB Statement No. 157, *Fair Value Measurements* ( SFAS 157 or the Statement ) and related interpretations. The Company determines fair value to be the price that would be received for an investment in a current sale, which assumes an orderly transaction between market participants on the measurement date. The Company's valuation policy considers the fact that no ready market exists for substantially all of the securities in which it invests and that fair value for its investments must typically be determined using unobservable inputs. The Company's valuation policy is intended to provide a consistent basis for determining the fair value of the portfolio.

The Company adopted SFAS 157 on a prospective basis in the first quarter of 2008. SFAS 157 requires the Company to assume that the portfolio investment is to be sold in the principal market to market participants, or in the absence of a principal market, the most advantageous market, which may be a hypothetical market. Market participants are

defined as buyers and sellers in the principal or most advantageous market that are independent, knowledgeable, and willing and able to transact. In accordance

**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 2. Summary of Significant Accounting Policies, continued**

with the Statement, the Company has considered its principal market, or the market in which the Company exits its portfolio investments with the greatest volume and level of activity.

The Company has determined that for its buyout investments, where the Company has control or could gain control through an option or warrant security, both the debt and equity securities of the portfolio investment would exit in the merger and acquisition ( M&A ) market as the principal market generally through a sale or recapitalization of the portfolio company. The Company believes that the in-use premise of value (as defined in SFAS 157), which assumes the debt and equity securities are sold together, is appropriate as this would provide maximum proceeds to the seller. As a result, the Company uses the enterprise value methodology to determine the fair value of these investments under SFAS 157. Enterprise value means the entire value of the company to a market participant, including the sum of the values of debt and equity securities used to capitalize the enterprise at a point in time. Enterprise value is determined using various factors, including cash flow from operations of the portfolio company, multiples at which private companies are bought and sold, 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 Company allocates the enterprise value to these securities in order of the legal priority of the securities.

While the Company typically exits its securities upon the sale or recapitalization of the portfolio company in the M&A market, for investments in portfolio companies where the Company does not have control or the ability to gain control through an option or warrant security, the Company cannot typically control the exit of its investment into its principal market (the M&A market). As a result, in accordance with SFAS 157, the Company is required to determine the fair value of these investments assuming a sale of the individual investment (the in-exchange premise of value) in a hypothetical market to a hypothetical market participant. The Company continues to perform an enterprise value analysis for the investments in this category to assess the credit risk of the loan or debt security and to determine the fair value of its equity investment in these portfolio companies. The determined equity values are generally discounted when the Company has a minority ownership position, restrictions on resale, specific concerns about the receptivity of the capital markets to a specific company at a certain time, or other factors. For loan and debt securities, the Company performs a yield analysis assuming a hypothetical current sale of the investment. The yield analysis requires the Company to estimate the expected repayment date of the instrument and a market participant's required yield. The Company's estimate of the expected repayment date of a loan or debt security may be shorter than the legal maturity of the instruments as the Company's loans have historically been repaid prior to the maturity date. The yield analysis considers changes in interest rates and changes in leverage levels of the loan or debt security as compared to market interest rates and leverage levels. Assuming the credit quality of the loan or debt security remains stable, the Company will use the value determined by the yield analysis as the fair value for that security. A change in the assumptions that the Company uses to estimate the fair value of its loans and debt securities using the yield analysis could have a material impact on the determination of fair value. If there is deterioration in credit quality or a loan or debt security is in workout status, the Company may consider other factors in determining the fair value of a loan or debt security, including the value attributable to the loan or debt security from the enterprise value of the portfolio company or the proceeds that would be received in a liquidation analysis.

The Company's equity investments in private debt and equity funds generally are valued based on the fund's net asset value, unless other factors lead to a determination of fair value at a different amount.



**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 2. Summary of Significant Accounting Policies, continued**

The value of the Company's equity securities in public companies for which quoted prices in an active market are readily available is based on the closing public market price on the measurement date.

The fair value of the Company's CLO bonds and preferred shares/income notes and CDO bonds ( CLO/CDO Assets ) is generally based on a discounted cash flow model that utilizes prepayment, re-investment, loss and ratings 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. The Company recognizes unrealized appreciation or depreciation on its CLO/CDO Assets as comparable yields in the market change and/or based on changes in estimated cash flows resulting from changes in prepayment, re-investment, loss or ratings assumptions in the underlying collateral pool or changes in redemption assumptions for the CLO/CDO Assets, if applicable. The Company determines the fair value of its CLO/CDO Assets on an individual security-by-security basis.

The Company records unrealized depreciation on investments when it determines that the fair value of a security is less than its cost basis, and records unrealized appreciation when it determines that the fair value is greater than its cost basis. Because of the inherent uncertainty of valuation, the values determined at the measurement date 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. Additionally, changes in the market environment and other events that may occur over the life of the investments may cause the gains or losses ultimately realized on these investments to be different than the values determined at the measurement date. In accordance with FSP 157-4 (discussed below), the Company does not consider a transaction price that is associated with a transaction that is not orderly to be indicative of fair value or market participant risk premiums, and accordingly would place little, if any, weight on transactions that are not orderly in determining fair value. When considering recent potential or completed transactions, the Company uses judgment in determining if such offers or transactions were pursuant to an orderly process for purposes of determining how much weight is placed on these data points in accordance with the applicable guidelines in SFAS 157 and FSP 157-4.

***Net Realized Gains or Losses and Net Change in Unrealized Appreciation or Depreciation***

Realized gains or losses are measured by the difference between the net proceeds from the repayment or sale and the cost basis of the investment without regard to unrealized appreciation or depreciation previously recognized, and include investments charged off during the period, net of recoveries. Net change in unrealized appreciation or depreciation primarily reflects the change in portfolio investment values during the reporting period, including the reversal of previously recorded unrealized appreciation or depreciation when gains or losses are realized. Net change in unrealized appreciation or depreciation also reflects the change in the value of U.S. Treasury bills, when applicable, and depreciation on accrued interest and dividends receivable and other assets where collection is doubtful.

***Interest and Dividend Income***

Interest income is recorded on an accrual basis to the extent that such amounts are expected to be collected. For loans and debt securities with contractual payment-in-kind interest, which represents contractual interest accrued and added to the loan balance that generally becomes due at maturity, the Company will not accrue payment-in-kind interest if the portfolio company valuation indicates that the



**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 2. Summary of Significant Accounting Policies, continued**

payment-in-kind interest is not collectible. In general, interest is not accrued on loans and debt securities if the Company has doubt about interest collection or where the enterprise value of the portfolio company may not support further accrual. Interest may not accrue on loans or debt securities to portfolio companies that are more than 50% owned by the Company depending on such company's capital requirements.

When the Company receives nominal cost warrants or free equity securities ( nominal cost equity ), the Company allocates its cost basis in its investment between its debt securities and its nominal cost equity at the time of origination. At that time, the original issue discount basis of the nominal cost equity is recorded by increasing the cost basis in the equity and decreasing the cost basis in the related debt securities. Loan origination fees, original issue discount, and market discount are capitalized and then amortized into interest income using a method that approximates the effective interest method. Upon the prepayment of a loan or debt security, any unamortized loan origination fees are recorded as interest income and any unamortized original issue discount or market discount is recorded as a realized gain.

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 Company recognizes interest income on the CLO preferred shares/income notes using the effective interest method, based on the anticipated yield that is determined using the estimated cash flows over the projected life of the investment. Yields are revised when there are changes in actual or estimated cash flows due to changes in prepayments and/or re-investments, credit losses, ratings or asset pricing. Changes in estimated yield are recognized as an adjustment to the estimated yield over the remaining life of the preferred shares/income notes from the date the estimated yield was changed. CLO and CDO bonds have stated interest rates. The weighted average yield on the CLO/CDO Assets is calculated as the (a) annual stated interest or the effective interest yield on the accruing bonds or the effective yield on the preferred shares/income notes, divided by (b) CLO/CDO Assets at value. The weighted average yields are computed as of the balance sheet date.

Dividend income on preferred equity securities is recorded as dividend income on an accrual basis to the extent that such amounts are expected to be collected and to the extent that the Company has the option to receive the dividend in cash. Dividend income on common equity securities is recorded on the record date for private companies or on the ex-dividend date for publicly traded companies.

***Fee Income***

Fee income includes fees for loan prepayment premiums, guarantees, commitments and services rendered by the Company to portfolio companies and other third parties such as diligence, structuring, transaction services, management and consulting services, and other services. Loan prepayment premiums are recognized at the time of prepayment. Guaranty and commitment fees are generally recognized as income over the related period of the guaranty or commitment, respectively. Diligence, structuring, and transaction services fees are generally recognized as income when services are rendered or when the related transactions are completed. Management, consulting and other services fees, including fund





**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 2. Summary of Significant Accounting Policies, continued**

management fees, generally are recognized as income as the services are rendered. Fees are not accrued if the Company has doubt about collection of those fees.

***Guarantees***

Guarantees meeting the characteristics described in FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* and issued or modified after December 31, 2002, are recognized at fair value at inception. Guarantees made on behalf of portfolio companies are considered in determining the fair value of the Company's investments. See Note 5.

***Financing Costs***

Debt financing costs are based on actual costs incurred in obtaining debt financing and generally are deferred and amortized as part of interest expense over the term of the related debt instrument using a method that approximates the effective interest method. Costs associated with the issuance of common stock are recorded as a reduction to the proceeds from the sale of common stock. Financing costs generally include underwriting, accounting and legal fees, and printing costs.

***Dividends to Shareholders***

Dividends to shareholders are recorded on the ex-dividend date.

***Stock Compensation Plans***

The Company has a stock-based employee compensation plan. See Note 9. Effective January 1, 2006, the Company adopted the provisions of FASB Statement No. 123 (Revised 2004), *Share-Based Payment* (SFAS 123R). SFAS 123R was adopted using the modified prospective method of application, which required the Company to recognize compensation costs on a prospective basis beginning January 1, 2006. Accordingly, the Company did not restate prior year financial statements. 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, using the fair value amounts determined for pro forma disclosure under SFAS 123R. With respect to options granted on or after January 1, 2006, compensation cost based on estimated grant date fair value is recognized over the

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Note 2. Summary of Significant Accounting Policies, continued

related service period in the statement of operations. The stock option expense for the three and six months ended June 30, 2009 and 2008, was as follows:

(\$ in millions, except per share amounts)	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2009	2008	2009	2008
Employee Stock Option Expense:				
Previously awarded, unvested options as of January 1, 2006	\$	\$2.1	\$	\$3.9
Options granted on or after January 1, 2006	1.2	1.8	2.0	4.2
Total employee stock option expense	\$1.2	\$3.9	\$2.0	\$8.1
Per basic share	\$0.01	\$0.02	\$0.01	\$0.05
Per diluted share	\$0.01	\$0.02	\$0.01	\$0.05

**Options Granted.** The stock option expense shown in the table above was based on the underlying value of the options granted by the Company. The fair value of each option grant was estimated on the date of grant using the Black-Scholes option pricing model and expensed over the vesting period. The following weighted average assumptions were used to calculate the fair value of options granted during the three and six months ended June 30, 2009 and 2008:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2009	2008	2009	2008
Expected term (in years)	3.0	5.0	3.0	5.0
Risk-free interest rate	1.3%	3.2%	1.3%	2.7%
Expected volatility	119.4%	28.9%	105.0%	27.7%
Dividend yield	10.6%	8.5%	32.5%	8.5%
Weighted average fair value per option	\$1.26	\$2.09	\$0.21	\$2.19

The expected term of the options granted represents the period of time that such options are expected to be outstanding. To determine the expected term of the options, the Company used historical and other data to estimate option exercise time frames, including considering employee terminations. The risk free rate was based on the U.S. Treasury bond yield curve at the date of grant consistent with the expected term. Expected volatilities were determined based on the historical volatility of the Company's common stock over a historical time period consistent with the expected term. The dividend yield was determined based on an estimate of the Company's future dividends over the expected term, relative to the option price. The estimate of future dividends takes into consideration the

Company's estimate of future taxable income required to be distributed in order to maintain its status as a registered investment company (see Federal and State Income Taxes and Excise Tax below). The Company currently is not paying a dividend and may or may not be able to pay a dividend during the expected term. In addition, actual future taxable income and dividends may significantly differ from these estimates.

To determine the stock options expense for options granted, the calculated fair value of the options granted is applied to the options granted, net of assumed future option forfeitures. The Company estimates that the employee-related stock option expense will be \$4.4 million, \$4.4 million, and \$3.7 million for the years ended December 31, 2009, 2010, and 2011, respectively. This estimate may

**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 2. Summary of Significant Accounting Policies, continued**

change if the Company's assumptions related to future option forfeitures change. This estimate does not include any expense related to stock option grants after June 30, 2009, as the fair value of those stock options will be determined at the time of grant. The aggregate total stock option expense remaining as of June 30, 2009, is expected to be recognized over an estimated weighted-average period of 1.48 years.

***Federal and State Income Taxes and Excise Tax***

The Company has complied with the requirements of the Code that are applicable to regulated investment companies ( RIC ) and real estate investment trusts ( REIT ). ACC and any subsidiaries that qualify as a RIC or a REIT intend to distribute or retain through a deemed distribution all of their annual taxable income to shareholders; therefore, the Company has made no provision for income taxes exclusive of excise taxes for these entities.

If the Company does not distribute at least 98% of its annual taxable income in the year earned, the Company generally will be required to pay an excise tax equal to 4% of the amount by which 98% of the Company's annual taxable income exceeds the distributions from such taxable income during the year earned. To the extent that the Company determines that its estimated current year annual taxable income will be in excess of estimated current year dividend distributions from such taxable income, the Company accrues excise taxes on estimated excess taxable income as taxable income is earned using an annual effective excise tax rate. The annual effective excise tax rate is determined by dividing the estimated annual excise tax by the estimated annual taxable income.

Income taxes for AC Corp are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases as well as operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

***Per Share Information***

Basic earnings per common share is calculated using the weighted average number of common shares outstanding for the period presented. Diluted earnings per common share reflects the potential dilution that could occur if options to issue common stock were exercised into common stock. Common stock equivalents of 3,045,554 shares and 4,835 shares were not included in the calculation of diluted earnings (loss) per common share for the six months ended June 30, 2009 and 2008, respectively, as the effect would have been antidilutive.

***Use of Estimates in the Preparation of Financial Statements***

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from these estimates.

The consolidated financial statements include portfolio investments at value of \$2.6 billion and \$3.5 billion at June 30, 2009, and December 31, 2008, respectively. At June 30, 2009, and December 31,



**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 2. Summary of Significant Accounting Policies, continued**

2008, 79% and 94%, respectively, of the Company's total assets represented portfolio investments whose fair values have been determined by the Board of Directors in good faith in the absence of readily available market values. Because of the inherent uncertainty of valuation, the Board of Directors' determined values 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.

***Recent Accounting Pronouncements***

*Fair Value Measurements.* In September 2006, the FASB issued Statement No. 157, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This statement was effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years.

The Company adopted this statement on a prospective basis beginning in the quarter ended March 31, 2008. The initial adoption of this statement did not have a material effect on the Company's consolidated financial statements.

*The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115.* In February 2007, the FASB issued Statement No. 159, which permits an entity to choose to measure many financial instruments and certain other items at fair value. This statement applies to all reporting entities, and contains financial statement presentation and disclosure requirements for assets and liabilities reported at fair value as a consequence of the election. This statement was effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years.

The Company did not elect fair value measurement for assets or liabilities other than portfolio investments, which already were required to be measured at fair value, therefore, the adoption of this statement did not impact the Company's consolidated financial position or its results of operations.

*Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active ( FSP 157-3 ).* In October 2008, the FASB issued FSP 157-3, which applies to financial assets within the scope of accounting pronouncements that require or permit fair value measurements in accordance with Statement 157. FSP 157-3 clarifies the application of Statement 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value.

The Company applied the provisions of FSP 157-3 in determining the fair value of its portfolio investments at December 31, 2008. The application of FSP 157-3 did not have a material impact on the Company's consolidated financial position or its results of operations.

*Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly ( FSP 157-4 ).* In April 2009, the FASB issued FSP 157-4, which provides guidance on how to determine the fair value of assets under SFAS 157 in the current economic environment and reemphasizes that the objective of a fair value measurement remains an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. FSP 157-4 states that a transaction price that is associated with a transaction that is not orderly is

not determinative of fair value or market-participant risk premiums and companies should place little, if any, weight (compared with



**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

other indications of fair value) on transactions that are not orderly when estimating fair value or market risk premiums.

The Company adopted the provisions of FSP 157-4 on a prospective basis beginning in the quarter ending March 31, 2009. The adoption of the provisions of FSP 157-4 did not have a material effect on the Company's consolidated financial statements.

*Subsequent Events* ( SFAS 165 ). In May 2009, the FASB issued SFAS 165 which establishes general standards for reporting events that occur after the balance sheet date, but before financial statements are issued or are available to be issued. SFAS 165 requires the disclosure of the date through which an entity has evaluated subsequent events and whether that date represents the date the financial statements were issued or were available to be issued.

The Company adopted the provisions of SFAS 165 in the quarter ended June 30, 2009. The adoption of SFAS 165 did not have a material impact on the Company's financial statements.

*Accounting for Transfers of Financial Assets* ( SFAS 166 ). In June 2009, the FASB issued SFAS 166, which changes the conditions for reporting a transfer of a portion of a financial asset as a sale and requires additional year-end and interim disclosures. SFAS 166 is effective for fiscal years beginning after November 15, 2009.

The implementation of SFAS 166 is not expected to have a material impact on the Company's financial statements.

*The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles* ( SFAS 168 ). In July 2009, the FASB issued SFAS 168, which supersedes SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles*. SFAS 168 establishes the FASB Accounting Standards Codification, which will become the source of authoritative U.S. generally accepted accounting principles recognized by the FASB. SFAS 168 is effective for the period ending after September 15, 2009.

The implementation of SFAS 168 is not expected to have a material impact on the Company's financial statements.

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Note 3. Portfolio

*Private Finance*

At June 30, 2009, and December 31, 2008, the private finance portfolio consisted of the following:

(\$ in millions)	Cost	2009 Value	Yield <sup>(1)</sup>	Cost	2008 Value	Yield <sup>(1)</sup>
Loans and debt securities:						
Senior loans	\$ 558.8	\$ 287.1	4.9%	\$ 556.9	\$ 306.3	5.6%
Unitranche debt <sup>(2)</sup>	427.6	376.7	12.2%	527.5	456.4	12.0%
Subordinated debt <sup>(3)</sup>	1,787.5	1,186.6	13.8%	2,300.1	1,829.1	12.9%
Total loans and debt securities <sup>(4)</sup>	2,773.9	1,850.4	12.1%	3,384.5	2,591.8	11.9%
Equity securities:						
Preferred shares/income notes of CLOs <sup>(5)</sup>	247.5	82.1	11.1%	248.2	179.2	16.4%
Subordinated certificates in Senior Secured Loan Fund LLC <sup>(5)</sup>	166.3	154.2	10.0%	125.4	125.4	12.0%
Other equity securities	1,063.7	389.6		1,119.3	502.7	
Total equity securities	1,477.5	625.9		1,492.9	807.3	
Total	\$ 4,251.4	\$ 2,476.3		\$ 4,877.4	\$ 3,399.1	

<sup>(1)</sup> 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. At June 30, 2009, and December 31, 2008, senior loans included the senior secured loan to Ciena totaling \$319.0 million and \$319.0 million at cost, respectively, and \$93.0 million and \$104.9 million at value, respectively, which was placed on non-accrual status on the purchase date.

The weighted average yield on the preferred shares/income notes of CLOs is calculated as the (a) effective interest yield on the preferred shares/income notes of CLOs, divided by (b) total preferred shares/income notes of CLOs at value. The weighted average yields are computed as of the balance sheet date. The yield on the CLO assets represents the yield used for recording interest income. The market yield used in the valuation of the CLO assets may be different than the interest yields.

The weighted average yield on the subordinated certificates in the Senior Secured Loan Fund LLC is computed as the (a) annual stated interest divided by (b) total investment at value.

- (2) Unitranche debt is an investment that combines both senior and subordinated financing, generally in a first lien position.
- (3) Subordinated debt includes bonds in CLOs and in a CDO.
- (4) The total principal balance outstanding on loans and debt securities was \$2,802.2 million and \$3,418.0 million at June 30, 2009, and December 31, 2008, respectively. The difference between principal and cost is represented by unamortized loan origination fees and costs, original issue discounts, and market discounts totaling \$28.3 million and \$33.5 million at June 30, 2009, and December 31, 2008, respectively.
- (5) Investments in the preferred shares/income notes of CLOs and the subordinated certificates in Senior Secured Loan Fund LLC earn a current return that is included in interest income in the accompanying consolidated statement of operations.

The Company's private finance investment activity principally involves providing financing through privately negotiated long-term debt and equity investments. The Company's private finance debt and equity investments generally are issued by private companies and generally are illiquid and may be subject to certain restrictions on resale.

The Company's private finance debt investments are generally structured as loans and debt securities that carry a relatively high fixed rate of interest, which may be combined with equity features, such as conversion privileges, or warrants or options to purchase a portion of the portfolio company's equity at a pre-determined strike price, which is generally a nominal price for warrants or options in a private company. The annual stated interest rate is only one factor in pricing the investment relative to the Company's rights and priority in the portfolio company's capital structure, and will vary depending on many factors, including if the Company has received nominal cost equity or other components of investment return, such as loan origination fees or market discount. The stated interest rate may include

**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 3. Portfolio, continued**

some component of contractual payment-in-kind interest, which represents contractual interest accrued and added to the loan balance that generally becomes due at maturity.

At June 30, 2009, 81% of the private finance loans and debt securities had a fixed rate of interest and 19% had a floating rate of interest. At December 31, 2008, 85% of the private finance loans and debt securities had a fixed rate of interest and 15% had a floating rate of interest. Senior loans may carry a fixed rate of interest or a floating rate of interest, usually set as a spread over prime or LIBOR, and may require payments of both principal and interest throughout the life of the loan. Senior loans generally have contractual maturities of three to six years and interest is generally paid to the Company monthly or quarterly. Unitranche debt generally carries a fixed rate of interest and generally requires payments of both principal and interest throughout the life of the loan. Unitranche debt generally has contractual maturities of five to six years and interest generally is paid to the Company quarterly. Subordinated debt generally carries a fixed rate of interest generally with contractual maturities of five to ten years and generally has interest-only payments in the early years and payments of both principal and interest in the later years, although maturities and principal amortization schedules may vary. Interest on subordinated debt generally is paid to the Company quarterly.

Equity securities primarily consist of securities issued by private companies and may be subject to certain restrictions on their resale and are generally illiquid. The Company may make equity investments for minority stakes in portfolio companies or may receive equity features, such as nominal cost warrants. The Company also may invest in the equity (preferred and/or voting or non-voting common) of a portfolio company where the Company's equity ownership may represent a significant portion of the equity, but may or may not represent a controlling interest. If the Company invests in non-voting equity in a buyout investment, the Company generally has the option to acquire a controlling stake in the voting securities of the portfolio company at fair market value. The Company may incur costs associated with making buyout investments that will be included in the cost basis of the Company's equity investment. These include costs such as legal, accounting and other professional fees associated with diligence, referral and investment banking fees, and other costs. Equity securities generally do not produce a current return, but are held with the potential for investment appreciation and ultimate gain on sale.

**Ciena Capital LLC.** Ciena Capital LLC (f/k/a Business Loan Express, LLC) (Ciena) has provided loans to commercial real estate owners and operators. Ciena has been a participant in the Small Business Administration's 7(a) Guaranteed Loan Program and its wholly-owned subsidiary is licensed by the SBA as a Small Business Lending Company (SBLC). Ciena is headquartered in New York, NY.

On September 30, 2008, Ciena voluntarily filed for bankruptcy protection under Chapter 11 of Title 11 of the United States Code (the Bankruptcy Code) in the United States Bankruptcy Court for the Southern District of New York (the Court). Ciena continues to operate its servicing business and manage its assets as a debtor-in-possession under the jurisdiction of the Court and in accordance with the applicable provisions of the Bankruptcy Code and the orders of the Court.

As a result of Ciena's decision to file for bankruptcy protection, the Company's unconditional guaranty of the obligations outstanding under Ciena's revolving credit facility became due and the Company, in lieu of paying under its guaranty, purchased the positions of the senior lenders under Ciena's revolving credit facility. As of June 30, 2009, the senior secured loan to Ciena had a cost basis of \$319.0 million and a value of \$93.0 million. The Company

continues to guarantee the remaining principal balance of \$5 million, plus related interest, fees and expenses payable to a third party bank. In connection with the Company's continuing guaranty of the amounts held by this bank, the Company has agreed that the amounts owing to the bank under the Ciena revolving credit facility will be paid before any of the secured obligations of Ciena now owed to the Company.

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**Note 3. Portfolio, continued**

At June 30, 2009 and December 31, 2008, the Company's investment in Ciena was as follows:

(\$ in millions)	June 30, 2009		December 31, 2008	
	Cost	Value	Cost	Value
Senior Loan	\$ 319.0	\$ 93.0	\$ 319.0	\$ 104.9
Class B Equity Interests <sup>(1)</sup>	119.5		119.5	
Class C Equity Interests <sup>(1)</sup>	109.1		109.3	
Total <sup>(2)</sup>	\$ 547.6	\$ 93.0	\$ 547.8	\$ 104.9

(1) At June 30, 2009 and December 31, 2008, the Company held 100% of the Class B equity interests and 94.9% of the Class C equity interests.

(2) In addition to the Company's investment in Ciena included in the portfolio, the Company has amounts receivable from or related to Ciena that are included in other assets in the accompanying consolidated financial statements. See below.

During the six months ended June 30, 2009, the Company funded \$51.4 million to support Ciena's term securitizations in lieu of draws under related standby letters of credit. This was required primarily as a result of the issuer of the letters of credit not extending maturing standby letters of credit due to events of default under the Company's Revolving Line of Credit. See Note 5. The amounts funded were recorded as other assets in the accompanying consolidated balance sheet. At June 30, 2009 and December 31, 2008, other assets included amounts receivable from or related to Ciena totaling \$66.8 million and \$15.4 million, respectively, at cost and \$2.0 million and \$2.1 million, respectively, at value. Net change in unrealized appreciation or depreciation included a net decrease related to the Company's investment in and receivables from Ciena of \$18.9 million and \$63.0 million for the three and six months ended June 30, 2009, respectively. Net change in unrealized appreciation or depreciation included a net decrease in the Company's investment in Ciena of \$29.3 million and \$68.6 million for the three and six months ended June 30, 2008, respectively.

In addition, at June 30, 2009, the Company had standby letters of credit issued under the Company's line of credit of \$46.0 million issued in connection with term securitizations completed by Ciena. The Company's asset coverage ratio currently is less than 200% and events of default have occurred and are continuing under the Company's revolving line of credit. Therefore, the Company is precluded from borrowing under its line of credit to fund these standby letters of credit. The Company expects that the remaining standby letters of credit will not be extended by the issuer and the Company will need to fund with cash up to the full amount of the remaining letters of credit on or prior to their maturity unless the Company is able to obtain replacement standby letters of credit. The remaining standby letters of credit mature by the end of October 2009. The Company has considered the letters of credit in the valuation of Ciena at June 30, 2009 and December 31, 2008.

The Company's investment in Ciena was on non-accrual status, therefore the Company did not earn any interest and related portfolio income from its investment in Ciena for each of the three and six months ended June 30, 2009 and

2008.

At June 30, 2009, Ciena had two non-recourse securitization warehouse facilities, both of which have matured. In order to pay down debt under the conventional loan warehouse facility, Ciena sold the loans on behalf of the conventional loan warehouse facility providers. Ciena is also working with the providers of the SBA loan warehouse facility with regard to the repayment of that facility. The Company has issued performance guaranties whereby the Company agreed to indemnify the warehouse providers for any damages, losses, liabilities and related costs and expenses that they may incur as a result of

**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 3. Portfolio, continued**

Ciena's failure to perform any of its obligations as loan originator, loan seller or loan servicer under the warehouse securitizations.

The Office of the Inspector General of the SBA (OIG) and the United States Secret Service are conducting ongoing investigations of allegedly fraudulently obtained SBA-guaranteed loans issued by Ciena. Ciena also is subject to other SBA and OIG audits, investigations, and reviews. In addition, the Office of the Inspector General of the U.S. Department of Agriculture is conducting an investigation of Ciena's lending practices under the Business and Industry Loan (B&I) program. The OIG and the U.S. Department of Justice are also conducting a civil investigation of Ciena's lending practices in various jurisdictions. The Company is unable to predict the outcome of these inquiries, and it is possible that third parties could try to seek to impose liability against the Company in connection with certain defaulted loans in Ciena's portfolio. These investigations, audits and reviews are ongoing.

These investigations, audits, reviews, and litigation have had and may continue to have a material adverse impact on Ciena and, as a result, could continue to negatively affect the Company's financial results. The Company has considered Ciena's voluntary filing for bankruptcy protection, the letters of credit, current regulatory issues, ongoing investigations and litigation in performing the valuation of Ciena at June 30, 2009 and at December 31, 2008.



## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Note 3. Portfolio, continued

*Collateralized Loan Obligations ( CLOs ) and Collateralized Debt Obligations ( CDOs )*. At June 30, 2009, and December 31, 2008, the Company owned bonds and preferred shares/income notes in CLOs and bonds in a CDO as follows:

(\$ in millions)	Cost	2009 Value	Yield <sup>(1)</sup>	Cost	2008 Value	Yield <sup>(1)</sup>
<i>Bonds<sup>(2)</sup>:</i>						
Callidus Debt Partners CDO Fund I, Ltd.	\$ 29.0	\$ 4.9	%	\$ 28.4	\$ 10.1	39.4%
Callidus Debt Partners CLO Fund IV, Ltd.	2.1	1.6	21.4%	2.0	1.4	26.9%
Callidus Debt Partners CLO Fund VI, Ltd.	7.4	3.8	22.7%	7.1	3.9	26.1%
Callidus MAPS CLO Fund I LLC	17.0	10.2	10.2%	17.0	9.8	12.2%
Callidus MAPS CLO Fund II LLC	3.7	3.0	25.9%	3.6	3.0	30.2%
Dryden XVIII Leveraged Loan 2007 Limited	7.9	2.3	%	7.7	4.5	20.5%
Knightsbridge CLO 2007-1 Ltd. <sup>(3)</sup>	18.7	11.3	16.7%	18.7	14.9	17.4%
Knightsbridge CLO 2008-1 Ltd. <sup>(3)</sup>	31.7	28.1	12.0%	31.4	31.4	10.2%
Pangaea CLO 2007-1 Ltd.	11.9	6.2	18.5%	11.8	7.1	25.0%
Total bonds	129.4	71.4	13.2%	127.7	86.1	18.5%
<i>Preferred Shares/Income Notes:</i>						
Callidus Debt Partners CLO Fund III, Ltd.	20.1	1.5	%	20.1	5.4	%
Callidus Debt Partners CLO Fund IV, Ltd.	15.0	4.2	%	14.6	10.6	18.1%
Callidus Debt Partners CLO Fund V, Ltd.	13.7	4.6	2.2%	13.4	10.3	21.3%
Callidus Debt Partners CLO Fund VI, Ltd.	29.1	5.6	%	28.3	23.1	21.8%
Callidus Debt Partners CLO Fund VII, Ltd.	24.8	4.8	%	24.0	15.4	17.9%
Callidus MAPS CLO Fund I LLC	42.5	12.4	%	45.1	27.8	6.5%
Callidus MAPS CLO Fund II, Ltd.	18.3	4.1	%	18.4	12.6	19.3%
Dryden XVIII Leveraged Loan 2007 Limited	23.2	0.8	%	22.1	17.5	20.2%
Knightsbridge CLO 2007-1 Ltd. <sup>(3)</sup>	39.6	25.8	20.7%	40.9	35.2	17.4%
Knightsbridge CLO 2008-1 Ltd. <sup>(3)</sup>	21.2	18.3	20.1%	21.3	21.3	16.6%
Total preferred shares/income notes	247.5	82.1	11.1%	248.2	179.2	16.4%
Total	\$ 376.9	\$ 153.5		\$ 375.9	\$ 265.3	

(1) The weighted average yield is calculated as the (a) annual stated interest or the effective interest yield on the accruing bonds or the effective interest yield on the preferred shares/income notes, divided by (b) CLO and CDO assets at value. The yield on these debt and equity securities is included in interest income in the accompanying consolidated statement of operations.

The market yield used in the valuation of the CLO and CDO assets may be different than the interest yields shown above.

(2) These securities are included in private finance subordinated debt.

(3) These funds are managed by the Company through a wholly-owned subsidiary.

The initial yields on the cost basis of the CLO preferred shares and income notes are based on the estimated future cash flows expected to be paid to these CLO classes from the underlying collateral assets. As each CLO preferred share or income note ages, the estimated future cash flows are updated based on the estimated performance of the underlying collateral assets, and the respective yield on the cost basis is adjusted as necessary. As future cash flows are subject to uncertainties and contingencies that are difficult to predict and are subject to future events that may alter current assumptions, no assurance can be given that the anticipated yields to maturity will be achieved.

The bonds, preferred shares and income notes of the CLOs and CDO in which the Company has invested are junior in priority for payment of interest and principal to the more senior notes issued by the CLOs and CDO. Cash flow from the underlying collateral assets in the CLOs and CDO is generally allocated first to the senior bonds in order of priority, then any remaining cash flow is generally

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Note 3. Portfolio, continued

distributed to the preferred shareholders and income note holders. To the extent there are ratings downgrades, defaults and unrecoverable losses on the underlying collateral assets that result in reduced cash flows, the preferred shares/income notes will bear this loss first and then the subordinated bonds would bear any loss after the preferred shares/income notes. At both June 30, 2009, and December 31, 2008, the face value of the CLO and CDO assets held by the Company was subordinate to as much as 94% of the face value of the securities outstanding in these CLOs and CDO.

At June 30, 2009, and December 31, 2008, the underlying collateral assets of these CLO and CDO issuances, consisting primarily of senior corporate loans, were issued by 649 issuers and 658 issuers, respectively, and had balances as follows:

(\$ in millions)	2009	2008
Bonds	\$ 233.8	\$ 268.3
Syndicated loans	4,456.8	4,477.3
Cash <sup>(1)</sup>	99.4	89.6
Total underlying collateral assets at cost <sup>(2)</sup>	\$ 4,790.0	\$ 4,835.2

(1) Includes undrawn liability amounts.

(2) At June 30, 2009, and December 31, 2008, the total cost basis of defaulted obligations was \$167.8 million and \$95.0 million, respectively, or approximately 3.5% and 2.0% respectively, of the total underlying collateral assets.

**Loans and Debt Securities on Non-Accrual Status.** At June 30, 2009, and December 31, 2008, private finance loans and debt securities at value not accruing interest were as follows:

(\$ in millions)	2009	2008
Loans and debt securities		
Companies more than 25% owned	\$ 155.0	\$ 176.1
Companies 5% to 25% owned	14.4	
Companies less than 5% owned	74.8	151.8
Total	\$ 244.2	\$ 327.9

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Note 3. Portfolio, continued

**Industry and Geographic Compositions.** The industry and geographic compositions of the private finance portfolio at value at June 30, 2009, and December 31, 2008, were as follows:

	2009	2008
<b>Industry</b>		
Business services	32%	36%
Consumer products	25	24
Financial services	8	6
Private debt funds	8	5
CLO/CDO <sup>(1)</sup>	6	8
Consumer services	6	5
Retail	3	5
Industrial products	3	5
Healthcare services	2	2
Other	7	4
Total	100%	100%
<b>Geographic Region<sup>(2)</sup></b>		
Mid-Atlantic	41%	41%
Midwest	30	28
Southeast	16	17
West	12	13
Northeast	1	1
Total	100%	100%

(1) These funds primarily invest in senior corporate loans. Certain of these funds are managed by Callidus Capital, a portfolio company of Allied Capital.

(2) The geographic region for the private finance portfolio depicts the location of the headquarters for the Company's portfolio companies. The portfolio companies may have a number of other locations in other geographic regions.

**Commercial Real Estate Finance**

At June 30, 2009, and December 31, 2008, the commercial real estate finance portfolio consisted of the following:

(\$ in millions)	2009			2008		
	Cost	Value	Yield <sup>(1)</sup>	Cost	Value	Yield <sup>(1)</sup>
Commercial mortgage loans	\$ 54.3	\$ 53.0	6.5%	\$ 52.5	\$ 53.5	7.4%
Real estate owned	5.9	6.6		18.2	20.8	

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Equity interests	13.5	14.1	14.8	19.6
Total	\$ 73.7	\$ 73.7	\$ 85.5	\$ 93.9

- (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.

**Commercial Mortgage Loans and Equity Interests.** The commercial mortgage loan portfolio contains loans that were originated by the Company or were purchased from third-party sellers. At June 30,

**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 3. Portfolio, continued**

2009, and December 31, 2008, approximately 67% and 69% of the Company's commercial mortgage loan portfolio was composed of fixed interest rate loans, respectively, and 33% and 31% of the Company's commercial loan portfolio was composed of adjustable interest rate loans, respectively. At June 30, 2009, and December 31, 2008, loans with a value of \$9.8 million and \$7.7 million, respectively, were not accruing interest. Loans greater than 120 days delinquent generally do not accrue interest.

Equity interests primarily consist of equity securities issued by privately owned companies that invest in single real estate properties. These equity interests may be subject to certain restrictions on their resale and are generally illiquid. Equity interests generally do not produce a current return, but are generally held in anticipation of investment appreciation and ultimate realized gain on sale.

The property types and the geographic composition securing the commercial real estate finance portfolio at value at June 30, 2009, and December 31, 2008, were as follows:

	<b>2009</b>	<b>2008</b>
<b>Property Type</b>		
Hospitality	55%	52%
Recreation	30	22
Office	13	15
Retail		9
Other	2	2
Total	100%	100%
<b>Geographic Region</b>		
Southeast	46%	43%
West	30	26
Midwest	15	22
Northeast	9	9
Mid-Atlantic		
Total	100%	100%

***Fair Value Measurements***

The Company, as a BDC, has invested in illiquid securities including debt and equity securities of portfolio companies, CLO bonds and preferred shares/income notes, CDO bonds and investment funds. The Company's investments may be subject to certain restrictions on resale and generally have no established trading market. The Company values substantially all of its investments at fair value as determined in good faith by the Board of Directors in accordance with the Company's valuation policy and the provisions of the 1940 Act and SFAS 157 and related interpretations. The Company determines fair value to be the price that would be received for an investment in a

current sale, which assumes an orderly transaction between market participants on the measurement date. The Company's valuation policy considers the fact that no ready market exists for substantially all of the securities in which it invests and that fair value for its investments must typically be determined using unobservable inputs.

SFAS 157 establishes a fair value hierarchy that encourages the use of observable inputs, but allows for unobservable inputs when observable inputs do not exist. Inputs are classified into one of three categories:

Level 1 Quoted prices (unadjusted) in active markets for identical assets

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Note 3. Portfolio, continued

Level 2 Inputs other than quoted prices that are observable to the market participant for the asset or quoted prices in a market that is not active

Level 3 Unobservable inputs

When there are multiple inputs for determining the fair value of an investment, the Company classifies the investment in total based on the lowest level input that is significant to the fair value measurement.

The Company has \$415.0 million in investments in money market and other securities, which the Company has determined are Level 1 assets but are not included in the Company's investment portfolio. Portfolio assets measured at fair value on a recurring basis by level within the fair value hierarchy at June 30, 2009, were as follows:

(\$ in millions)	Fair Value Measurement as of June 30, 2009	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets at Fair Value:				
Portfolio				
Private finance:				
Loans and debt securities	\$ 1,850.4	\$	\$	\$ 1,850.4
Preferred shares/income notes of CLOs	82.1			82.1
Subordinated certificates in Senior Secured Loan Fund LLC	154.2			154.2
Other equity securities	389.6			389.6
Commercial real estate finance	73.7			73.7
Total portfolio	\$ 2,550.0	\$	\$	\$ 2,550.0

The table below sets forth a summary of changes in the Company's assets measured at fair value using level 3 inputs.

	Private Finance		Other Equity	Commercial
	Preferred	Subordinated		
Loans and Debt	Shares/	Certificates in		



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(\$ in millions)	Securities	Income Notes of CLOs	Senior Secured Loan Fund LLC	Securities	Real Estate Finance	Total
Balance at December 31, 2008	\$ 2,591.8	\$ 179.2	\$ 125.4	\$ 502.7	\$ 93.9	\$ 3,493.0
Total gains or losses						
Net realized gains (losses) <sup>(1)</sup>	(116.1)	9.5		(37.5)	(3.7)	(147.8)
Net change in unrealized appreciation or depreciation <sup>(2)</sup>	(130.7)	(96.3)	(12.1)	(57.6)	(8.3)	(305.0)
Purchases, issuances, repayments and exits, net <sup>(3)</sup>	(494.6)	(10.3)	40.9	(18.0)	(8.2)	(490.2)
Transfers in and/or out of level 3						
Balance at June 30, 2009	\$ 1,850.4	\$ 82.1	\$ 154.2	\$ 389.6	\$ 73.7	\$ 2,550.0
Net unrealized appreciation (depreciation) during the period relating to assets still held at the reporting date <sup>(2)</sup>	\$ (224.4)	\$ (96.3)	\$ (12.1)	\$ (75.2)	\$ (10.9)	\$ (418.9)

(1) Includes net realized gains (losses) (recorded as realized gains or losses in the accompanying consolidated statement of operations), and amortization of discounts and closing points (recorded as interest income in the accompanying consolidated statement of operations).

(2) Included in change in net unrealized appreciation or depreciation in the accompanying consolidated statement of operations.

Net change in unrealized appreciation or depreciation includes net unrealized appreciation (depreciation) resulting from changes in portfolio investment values during the reporting period and the reversal of previously recorded unrealized appreciation or depreciation when gains or losses are realized.

(3) Includes interest and dividend income reinvested through the receipt of a debt or equity security (payment-in-kind income) (recorded as interest and dividend income in the accompanying consolidated statement of operations).

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Note 3. Portfolio, continued

*Managed Funds*

In addition to managing its own assets, the Company manages certain funds that also invest in the debt and equity securities of primarily private middle market companies in a variety of industries. At June 30, 2009, the Company had eight separate funds under its management (together, the *Managed Funds* ) for which the Company may earn management or other fees for its services. The Company may invest in the equity of these funds, along with other third parties, from which the Company may earn a current return and/or a future incentive allocation.

On March 3, 2009, the Company announced the completion of the acquisition of the management contracts of three middle market senior debt CLOs (together, the *Emporia Funds* ) and certain other related assets for approximately \$11 million (subject to post-closing adjustments). The acquired assets are included in other assets in the accompanying consolidated balance sheet and the cost will be amortized over the life of the contracts. The Emporia Funds primarily invest in middle market and broadly syndicated senior secured loans. The Company is not an investor in the Emporia Funds.

The assets of the Managed Funds at June 30, 2009 and December 31, 2008, and the Company's management fees as of June 30, 2009, were as follows:

(\$ in millions) Name of Fund	Assets of Managed Funds		Management Fee <sup>(2)</sup>
	June 30, 2009	December 31, 2008	
Senior Secured Loan Fund LLC <sup>(3)</sup>	\$ 945.4	\$ 789.8	0.375%
Allied Capital Senior Debt Fund, L.P.	359.7	412.9	1.625% <sup>(1)(2)</sup>
Knightsbridge CLO 2007-1 Ltd.	503.0	500.6	0.600%
Knightsbridge CLO 2008-1 Ltd.	306.7	304.8	0.600%
Emporia Preferred Funding I, Ltd.	420.8		0.625% <sup>(1)</sup>
Emporia Preferred Funding II, Ltd.	354.0		0.650% <sup>(1)</sup>
Emporia Preferred Funding III, Ltd.	407.1		0.650% <sup>(1)</sup>
AGILE Fund I, LLC	85.2	99.3	(1)
Total Assets	\$ 3,381.9	\$ 2,107.4	

(1) The Company is entitled to an incentive allocation subject to certain performance benchmarks. There can be no assurance that the incentive allocation will be earned.

(2) Management fees are stated as a percent of assets except for the Allied Capital Senior Debt Fund, L.P. ( *ACSDF* ) which is stated as a percent of equity capital. The management fee paid by ACSDF was 2.000% at December 31, 2008 and was reduced to 1.625% effective January 1, 2009 for the 2009 calendar year.

(3) In June 2009, the Unitranche Fund LLC was renamed the Senior Secured Loan Fund LLC.

A portion of the management fees earned by the Company may be deferred under certain circumstances. Collection of the fees earned may be dependent in part on the performance of the Managed Fund. The Company may pay a portion of management fees it receives to Callidus Capital Corporation, a portfolio investment controlled by the Company, for services provided to the Allied Capital Senior Debt Fund, L.P., Knightsbridge CLO 2007-1 Ltd., Knightsbridge CLO 2008-1 Ltd. and the Emporia Funds.

The Company's responsibilities to the Managed Funds may include investment origination, underwriting, and portfolio monitoring services. Each of the Managed Funds may separately invest in the debt or equity of companies in the Company's portfolio, and these investments may be senior, pari passu or

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**Note 3. Portfolio, continued**

junior to the debt and equity investments held by the Company. The Company may or may not participate in investments made by the Managed Funds.

The Company accounts for the sale of securities to funds with which it has continuing involvement as sales pursuant to SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, a replacement of FASB Statement 125*, when the securities have been legally isolated from the Company, the Company has no ability to restrict or constrain the ability of the Managed Funds to pledge or exchange the transferred securities, and the Company does not have either the entitlement and the obligation to repurchase the securities or the ability to unilaterally cause the Managed Fund to put the securities back to the Company.

During the six months ended June 30, 2009, the Company sold assets to certain of its Managed Funds for which the Company received proceeds of \$9.7 million and recognized a net realized gain of \$6.3 million. During the three and six months ended June 30, 2008, the Company sold assets to certain of the Managed Funds, for which the Company received proceeds of \$274.9 million and \$303.9 million, respectively, and recognized realized gains of \$5.3 million and \$4.2 million, respectively.

In addition to managing these funds, the Company holds certain investments in the Managed Funds as follows:

(\$ in millions) Name of Fund	Investment Description	June 30, 2009		December 31, 2008	
		Cost	Value	Cost	Value
Senior Secured Loan Fund LLC <sup>(1)</sup>	Subordinated Certificates and Equity Interests	\$ 166.3	\$ 154.2	\$ 125.4	\$ 125.4
Allied Capital Senior Debt Fund, L.P.	Equity interests	31.8	33.1	31.8	31.8
Knightsbridge CLO 2007-1 Ltd.	Class E Notes and Income Notes	58.3	37.2	59.6	50.1
Knightsbridge CLO 2008-1 Ltd.	Class C Notes, Class D Notes, Class E Notes and Income Notes	52.9	46.3	52.7	52.7
AGILE Fund I, LLC	Equity Interests	0.7	0.4	0.7	0.5
Total		\$ 310.0	\$ 271.2	\$ 270.2	\$ 260.5

<sup>(1)</sup> The Company has committed up to a total of \$525.0 million of subordinated certificates to the Senior Secured Loan Fund. The Senior Secured Loan Fund will be capitalized as investment transactions are completed. Investments made by the Senior Secured Loan Fund must be approved by the investment committee of the Senior Secured Loan Fund, which includes a representative from the Company. Therefore, this commitment to the Senior Secured Loan Fund cannot be drawn without the Company's approval.

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**Note 4. Debt**

At June 30, 2009, and December 31, 2008, the Company had outstanding debt as follows:

	2009			2008		
	Facility Amount	Amount Drawn	Annual Interest Cost <sup>(1)</sup>	Facility Amount	Amount Drawn	Annual Interest Cost <sup>(1)</sup>
(\$ in millions)						
Notes payable:						
Privately issued unsecured notes payable <sup>(5)</sup>	\$ 1,015.0	\$ 1,015.0	9.7%	\$1,015.0	\$1,015.0	7.8%
Publicly issued unsecured notes payable	745.5	745.5	6.7%	880.0	880.0	6.7%
Total notes payable	1,760.5	1,760.5	8.4%	1,895.0	1,895.0	7.3%
Revolving line of credit <sup>(4)</sup>	165.0	50.0	6.3% <sup>(2)</sup>	632.5	50.0	4.3% <sup>(2)</sup>
Total debt	\$ 1,925.5	\$ 1,810.5	8.6% <sup>(3)</sup>	\$2,527.5	\$1,945.0	7.7% <sup>(3)</sup>

- (1) The weighted average annual interest cost is computed as the (a) annual stated interest on the debt plus any applicable default interest, plus the annual amortization of commitment fees, other facility fees and amortization of 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. Events of default have occurred and are continuing under the Revolving Line of Credit and Private Notes which have increased the interest rates by 2.00% in 2009 during the continuance of such events of default.
- (2) The annual interest cost reflects the interest rate payable for borrowings under the revolving line of credit in effect at the balance sheet date. In addition to the current interest payable, there were annual costs of commitment fees, other facility fees and amortization of debt financing costs of \$4.6 million at June 30, 2009, and \$8.5 million at December 31, 2008.
- (3) The annual interest cost for total debt includes the annual cost of commitment fees, other facility fees and amortization of debt financing costs on the revolving line of credit regardless of the amount outstanding on the facility as of the balance sheet date. The annual interest cost reflects the facilities in place on the balance sheet date.
- (4) At June 30, 2009, \$62.0 million of the facility was committed for standby letters of credit issued under the credit facility. As of July 17, 2009, the commitments under the facility were reduced to \$115.0 million. See discussion below.
- (5) In the third quarter of 2009, the Company repaid \$100 million of its privately issued unsecured notes payable.

**Notes Payable**

**Revolving Line of Credit.** The Company has an unsecured revolving line of credit that expires on April 11, 2011 (the Revolving Line of Credit ). At June 30, 2009, there was \$50.0 million outstanding under the Company's Revolving

Line of Credit and standby letters of credit of \$62.0 million were issued under the credit facility. As of July 17, 2009, the commitments under the facility were reduced to \$115.0 million.

Borrowings under the Revolving Line of Credit generally bear interest at a rate per annum equal to (i) LIBOR (for the period selected by the Company) plus 3.00% or (ii) the higher of (a) the Federal Funds rate plus 1.50% or (b) the Bank of America N.A. prime rate plus 1.00%. The Revolving Line of Credit requires the payment of an annual commitment fee equal to 0.50% of the committed amount (whether used or unused). The Revolving Line of Credit generally requires payments of interest at the end of each LIBOR interest period, but no less frequently than quarterly, on LIBOR-based loans, and monthly payments of interest on other loans. All principal is due upon maturity.

The Revolving Line of Credit provides for a swingline sub-facility. The swingline sub-facility bears interest at the Bank of America N.A. cost of funds plus 2.00%. The Revolving Line of Credit also provides for a sub-facility for letters of credit. This sub-facility was reduced to \$65 million on July 17, 2009. The letter of credit fee is 3.00% per annum on letters of credit issued, which is payable quarterly. Events of default have increased the interest rate and fees on letters of credit by up to 2.00% during the continuance of such events of default. See Note 1.

***Privately Issued Unsecured Notes Payable.*** The Company has privately issued notes (the Private Notes ) to institutional investors, primarily insurance companies. The Private Notes have five- or seven-year maturities and stated fixed rates of interest ranging from 6.53% to 9.14% at June 30, 2009. Events of default have occurred which have increased these interest rates by 2.00% during the continuance of such events of default. See Note 1. The Private Notes generally require payment of interest only semi-annually, and all principal is due upon maturity. At June 30, 2009, the Private Notes had contractual

**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 4. Debt, continued**

maturities from November 2009 to June 2015. The Private Notes may be prepaid in whole or in part, together with an interest premium, if any, as stipulated in the private note agreements.

The Revolving Line of Credit and the Private Notes have similar financial and operating covenants. These covenants require the Company to maintain certain financial ratios, including asset coverage, debt to equity and interest coverage, and a minimum net worth. These debt agreements provide for customary events of default, including, but not limited to, payment defaults, breach of representations or covenants, cross-defaults, bankruptcy events, failure to pay judgments, attachment of its assets, change of control and the issuance of an order of dissolution. Certain of these events of default are subject to notice and cure periods or materiality thresholds. These debt agreements limit the Company's ability to declare dividends or repurchase its common stock during the existence of certain defaults and events of default.

***Amendments to Revolving Line of Credit and Privately Issued Unsecured Notes Payable.*** On December 30, 2008, the Company entered into amendments relating to the Company's Private Notes and Revolving Line of Credit. The amendments reduced the Company's capital maintenance covenant to the greater of \$1.5 billion and 85% of consolidated adjusted debt, and reduced the Company's interest charges coverage ratio covenant, determined as of the last day of each fiscal quarter for the period of four consecutive fiscal quarters ending on such day, to 1.4 to 1 for the fiscal quarter ending December 31, 2008 and each fiscal quarter thereafter to and including the fiscal quarter ending December 31, 2009, to 1.6 to 1 for the fiscal quarter ending March 31, 2010 and each fiscal quarter thereafter to and including the fiscal quarter ending December 31, 2010, and to 1.7 to 1 for the fiscal quarter ending March 31, 2011 and each fiscal quarter thereafter. The amendments did not modify the Company's obligation to maintain a minimum 200% asset coverage ratio.

The amendments added new covenants that required the Company to grant to the Noteholders and the Lenders a first priority lien on substantially all of the Company's assets no later than January 30, 2009, and to maintain a ratio of consolidated total adjusted assets to secured debt of not less than 2.25 to 1. Also, prior to December 31, 2010, the Company is (i) required to limit the payment of dividends to a maximum of \$0.20 per share per fiscal quarter (or such greater amount required for the Company to maintain its regulated investment company status), and (ii) restricted from purchasing, redeeming or retiring any shares of the Company's common stock or any warrants, rights or options to purchase or acquire any shares of the Company's common stock for an aggregate consideration in excess of \$60 million. In addition, the amendments restricted the Company from prepaying, redeeming, purchasing or otherwise acquiring any of its currently outstanding public notes prior to their stated maturity. The amendments also made certain other modifications. The amendments increased the rate of interest on the instruments by 100 basis points. In addition, these amendments required a 50 basis point amendment fee.

Events of default have occurred and are continuing under the Revolving Line of Credit and Private Notes related to certain financial and other covenants. See Note 1.

***Publicly Issued Unsecured Notes Payable.*** At June 30, 2009, the Company had outstanding publicly issued unsecured notes as follows:

<b>(\$ in millions)</b>	<b>Amount</b>	<b>Maturity Date</b>
6.625% Notes due 2011	\$319.9	July 15, 2011
6.000% Notes due 2012	195.6	April 1, 2012
6.875% Notes due 2047	230.0	April 15, 2047
Total	\$745.5	



**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 4. Debt, continued**

The 6.625% Notes due 2011 and the 6.000% Notes due 2012 require payment of interest only semi-annually, and all principal is due upon maturity. The Company has the option to redeem these notes in whole or in part, together with a redemption premium, as stipulated in the notes. In addition, the Company may purchase these notes in the market at par or at a discount to the extent permitted by the 1940 Act. During the six months ended June 30, 2009, the Company paid \$30.1 million to repurchase certain of the 6.625% Notes due 2011 which had a face value of \$80.1 million, and \$20.2 million to repurchase certain of the 6.000% Notes due 2012 which had a face value of \$54.4 million. After recognizing the remaining unamortized original issue discount associated with the notes repurchased, the Company recognized a net gain on repurchase of debt of \$81.5 million and \$83.5 million for the three and six months ended June 30, 2009, respectively.

The 6.875% Notes due 2047 require payment of interest only quarterly, and all principal is due upon maturity. These notes are redeemable in whole or in part at any time or from time to time on or after April 15, 2012, at par and upon the occurrence of certain tax events as stipulated in the notes.

The Company has certain financial and operating covenants that are required by the publicly issued unsecured notes payable. The Company is not permitted to issue indebtedness unless immediately after such issuance the Company has asset coverage of all outstanding indebtedness of at least 200% as required by the 1940 Act, as amended. At June 30, 2009, the Company's asset coverage ratio was 174%, which is less than the 200% requirement. As a result, under the publicly issued unsecured notes payable, the Company will not be able to issue indebtedness until such time as the Company's asset coverage returns to at least 200%. The Company has not experienced any default or cross default with respect to the publicly issued unsecured notes payable.

**Scheduled Maturities.** Scheduled future maturities of notes payable at June 30, 2009, were as follows:

(\$ in millions) Year	Amount Maturing		Total
	Privately Issued Unsecured Notes Payable <sup>(1)</sup>	Publicly Issued Unsecured Notes Payable	
2009	\$ 1,015.0	\$	\$ 1,015.0
2010			
2011		319.9	319.9
2012		195.6	195.6
2013			
Thereafter		230.0	230.0
Total	\$ 1,015.0	\$ 745.5	\$ 1,760.5

<sup>(1)</sup> The Private Notes have stated contractual maturities as follows: 2009 \$252.5 million, 2010 \$408.0 million, 2011 \$72.5 million, 2012 \$89.0 million, 2013 \$140.5 million and thereafter \$52.5 million. In the third quarter

of 2009, the Company repaid \$100.0 million, which reduced each of the Private Notes on a pro rata basis. See below.

**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 4. Debt, continued**

As discussed above and in Note 1, events of default have occurred and are continuing under the Revolving Line of Credit and Private Notes. Neither the Lenders nor Noteholders have accelerated repayment; however, if the administrative agent for the Lenders under the Revolving Line of Credit or the required percentage of Lenders under the Revolving Line of Credit or Noteholders under the Private Notes, respectively, were to accelerate repayment, these obligations would become immediately due and payable. Therefore, in the table above, the Private Notes are shown as payable in 2009.

**Fair Value of Debt**

The Company records debt at cost. The fair value of the Company's outstanding debt was approximately \$1.6 billion and \$1.4 billion at June 30, 2009 and December 31, 2008, respectively. The fair value of the Company's publicly issued 6.875% Notes due 2047 was determined using the market price of the retail notes at June 30, 2009 and December 31, 2008. The fair value of the Company's other debt was determined based on market interest rates for similar instruments as of the balance sheet dates.

**Note 5. Guarantees and Commitments**

In the ordinary course of business, the Company has issued guarantees and has extended standby letters of credit through financial intermediaries on behalf of certain portfolio companies. All standby letters of credit have been issued through Bank of America, N.A. As of June 30, 2009, and December 31, 2008, the Company had issued guarantees of debt and rental obligations aggregating \$19.2 million and \$19.2 million, respectively, and had extended standby letters of credit aggregating \$62.0 million and \$122.3 million, respectively. Under these arrangements, the Company would be required to make payments to third parties if the portfolio companies were to default on their related payment obligations or if the expiration dates of the letters of credit are not extended. The maximum amount of potential future payments was \$81.2 million and \$141.5 million at June 30, 2009, and December 31, 2008, respectively.

As of June 30, 2009, the guarantees and standby letters of credit expired as follows:

(in millions)	Total	2009	2010	2011	2012	2013	After 2013
Guarantees	\$ 19.2	\$ 7.5	\$ 6.4	\$ 4.4	\$ 0.1	\$	\$ 0.8
Standby letters of credit	62.0	62.0					
Total	\$ 81.2	\$ 69.5	\$ 6.4	\$ 4.4	\$ 0.1	\$	\$ 0.8

Standby letters of credit have been issued under the Revolving Line of Credit. The Company's asset coverage ratio is currently less than 200% and events of default have occurred and are continuing under the Revolving Line of Credit. Therefore, the Company is precluded from borrowing under its Revolving Line of Credit to fund these standby letters

of credit. During the existence of an event of default, the administrative agent is (i) permitted to require the Company to provide cash collateral equal to the face amount of all outstanding standby letters of credit and (ii) not required to extend the existing letters of credit beyond their maturity dates, all of which expire by October 2009. The Company expects that the remaining standby letters of credit will not be extended by the issuer and the Company will need to fund with cash up to the full amount of the remaining standby letters of credit on or prior to their maturity unless the Company is able to obtain replacement standby letters of credit. The remaining standby letters of credit mature by the end of October 2009. As a result, in the table above the Company has assumed that these standby letters of credit will not be extended and will mature in 2009.

**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 5. Guarantees and Commitments, continued**

In the ordinary course of business, the Company enters into agreements with service providers and other parties that may contain provisions for the Company to indemnify and guaranty certain minimum fees to such parties under certain circumstances.

At June 30, 2009, the Company had outstanding commitments to fund investments totaling \$568.4 million, including \$537.1 million related to private finance investments and \$31.3 million related to commercial real estate finance investments. Total outstanding commitments related to private finance investments included \$352.2 million to the Senior Secured Loan Fund LLC. Investments made by the Senior Secured Loan Fund must be approved by the investment committee of the Senior Secured Loan Fund, which includes a representative from the Company. Therefore, the Company's commitment to the Senior Secured Loan Fund cannot be drawn without the Company's approval. See Note 3.

**Note 6. Shareholders' Equity**

The Company did not sell any common stock during the six months ended June 30, 2009. The Company sold 20.5 million shares of its common stock during the six months ended June 30, 2008, for gross proceeds of \$417.1 million. The Company paid \$14.6 million in costs, including underwriting fees, for net proceeds of \$402.5 million.

The Company issued 0.3 million shares of common stock upon the exercise of stock options during the six months ended June 30, 2009. No stock options were exercised during the six months ended June 30, 2008.

The Company has a dividend reinvestment plan, whereby the Company may buy shares of its common stock in the open market or issue new shares in order to satisfy dividend reinvestment requests. If the Company issues new shares, the issue price is equal to the average of the closing sale prices reported for the Company's common stock for the five consecutive trading days immediately prior to the dividend payment date. The Company may not issue new shares below net asset value. During the six months ended June 30, 2009, the Company did not pay dividends and there was no activity in the dividend reinvestment plan. During the six months ended June 30, 2008, under the dividend reinvestment plan the Company issued 0.2 million shares at an average price of \$19.49 per share, and 0.3 million shares were purchased by a plan agent for shareholders at an average price of \$14.14 per share.

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**Note 7. Earnings Per Common Share**

Earnings per common share for the three and six months ended June 30, 2009 and 2008, were as follows:

(in millions, except per share amounts)	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2009	2008	2009	2008
Net increase (decrease) in net assets resulting from operations	\$ (29.1)	\$ (102.2)	\$ (376.7)	\$ (142.9)
Weighted average common shares outstanding basic	178.7	173.0	178.7	167.2
Dilutive options outstanding				
Weighted average common shares outstanding diluted	178.7	173.0	178.7	167.2
Basic earnings (loss) per common share	\$ (0.16)	\$ (0.59)	\$ (2.11)	\$ (0.85)
Diluted earnings (loss) per common share	\$ (0.16)	\$ (0.59)	\$ (2.11)	\$ (0.85)

**Note 8. Employee Compensation Plans**

The Company had an Individual Performance Award plan ( IPA ), and an Individual Performance Bonus plan ( IPB ), each individually a Plan, or collectively, the Plans ). These Plans generally were determined annually at the beginning of each year but could be adjusted throughout the year. In 2008, the IPA was paid in cash in two equal installments during the year. Through December 31, 2007, the IPA amounts were contributed into a trust and invested in the Company's common stock. The IPB was distributed in cash to award recipients throughout the year (beginning in February of each respective year) as long as the recipient remained employed by the Company. The Company currently has not established an IPA or IPB for 2009; however, depending upon the Company's need to retain and motivate its employees, the Company may determine in conjunction with the Compensation Committee of the Board of Directors that some form of 2009 retention compensation or additional individual performance compensation may be in the best interests of the Company.

The trusts for the IPA payments were consolidated with the Company's accounts. The common stock was classified as common stock held in deferred compensation trust in the accompanying financial statements and the deferred compensation obligation, which represented the amount owed to the employees, was included in other liabilities. Changes in the value of the Company's common stock held in the deferred compensation trust were not recognized. However, the liability was marked to market with a corresponding charge or credit to employee compensation expense.

In December 2007, the Company's Board of Directors made a determination that it was in the best interests of the Company to terminate its deferred compensation arrangements. The Board of Directors' decision primarily was in response to increased complexity resulting from changes in the regulation of deferred compensation arrangements. The Board of Directors resolved that the accounts under these Plans would be distributed to participants in full on March 18, 2008, the termination and distribution date, or as soon as was reasonably practicable thereafter, in accordance with the provisions of each of these Plans.

**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 8. Employee Compensation Plans, continued**

The accounts under the deferred compensation arrangements totaled \$52.5 million at December 31, 2007. The balances on the termination date were distributed to participants in March 2008 subsequent to the termination date in accordance with the transition rule for payment elections under Section 409A of the Code. Distributions from the plans were made in cash or shares of the Company's common stock, net of required withholding taxes.

The IPA and IPB expenses are included in employee expenses and for the three and six months ended June 30, 2009 and 2008, were as follows:

(\$ in millions)	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2009	2008	2009	2008
IPA	\$	\$ 2.2	\$	\$ 4.6
IPA mark to market expense (benefit)				(4.1)
Total IPA expense	\$	\$ 2.2	\$	\$ 0.5
Total IPB expense	\$	\$ 2.6	\$	\$ 4.3

**Note 9. Stock Option Plan**

The purpose of the stock option plan ( Option Plan ) is to provide officers and non-officer directors of the Company with additional incentives. Options are exercisable at a price equal to the fair market value of the shares on the day the option is granted. Each option states the period or periods of time within which the option may be exercised by the optionee, which may not exceed ten years from the date the option is granted. The options granted to officers generally vest ratably over up to a three year period. Options granted to non-officer directors vest on the grant date.

All rights to exercise options terminate 60 days after an optionee ceases to be (i) a non-officer director, (ii) both an officer and a director, if such optionee serves in both capacities, or (iii) an officer (if such officer is not also a director) of the Company for any cause other than death or total and permanent disability. In the event of a change of control of the Company, all outstanding options will become fully vested and exercisable as of the change of control.

At June 30, 2009, and December 31, 2008, there were 37.2 million shares authorized under the Option Plan and the number of shares available to be granted under the Option Plan was 2.2 million and 9.5 million, respectively.



## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**Note 9. Stock Option Plan, continued**

Information with respect to options granted, exercised and forfeited under the Option Plan for the six months ended June 30, 2009, was as follows:

(in millions, except per share amounts)	Shares	Weighted Average Exercise Price Per Share	Weighted Average Contractual Remaining Term (Years)	Aggregate Intrinsic Value at June 30, 2009 <sup>(1)</sup>
Options outstanding at January 1, 2009	19.7	\$ 26.56		
Granted	11.5	\$ 0.88		
Exercised	(0.3)	\$ 0.73		
Forfeited	(4.2)	\$ 26.91		
Options outstanding at June 30, 2009	26.7	\$ 15.76	5.82	\$ 29.0
Exercisable at June 30, 2009 <sup>(2)</sup>	15.7	\$ 21.73	5.49	\$ 9.0
Exercisable and expected to be exercisable at June 30, 2009 <sup>(3)</sup>	24.8	\$ 15.88	5.82	\$ 27.1

(1) Represents the difference between the market value of the options at June 30, 2009, and the cost for the option holders to exercise the options.

(2) Represents vested options.

(3) The amount of options expected to be exercisable at June 30, 2009, is calculated based on an estimate of expected forfeitures.

During the six months ended June 30, 2008, 7.5 million options were granted, no options were exercised and 1.5 million options were forfeited. The fair value of the options vested during the six months ended June 30, 2008 was \$13.5 million.

**Note 10. Dividends and Distributions and Taxes**

At December 31, 2008, the Company estimated that it did not have excess taxable income available for distribution to shareholders in 2009, and the Company's Board of Directors did not declare a dividend for the first or second quarter of 2009. The Company's Board of Directors declared and the Company paid a dividend of \$0.65 per common share for the first and second quarters of 2008, totaling \$224.2 million.

The Company generally will be required to pay an excise tax equal to 4% of the amount by which 98% of the Company's annual taxable income exceeds the distributions for the year. The Company records an excise tax based on the Company's estimated excess taxable income for the period. Such estimates may change from period to period. The Company did not record an excise tax for the three and six months ended June 30, 2009. The Company recorded an

excise tax of \$1.9 million and \$4.2 million for the three and six months ended June 30, 2008, respectively.

In certain circumstances, the Company is restricted in its ability to pay dividends. Each of the Company's Private Notes and the Company's Revolving Line of Credit contain provisions that limit the amount of dividends the Company can pay, and have a covenant that requires a minimum 200% asset coverage ratio at all times. At June 30, 2009, the Company was in default of that covenant (see Note 1). During the continuance of an event of default, the Company is precluded from declaring dividends or other distributions to its shareholders. In addition, pursuant to the 1940 Act, the Company may be

**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 10. Dividends and Distributions and Taxes, continued**

precluded from declaring dividends or other distributions to its shareholders unless the Company's asset coverage of senior securities is at least 200%.

The Company currently estimates that it had cumulative deferred taxable income related to installment sale gains of approximately \$217.4 million as of December 31, 2008. These gains have been recognized for financial reporting purposes in the respective years they were realized, but are generally deferred for tax purposes until the notes or other amounts received from the sale of the related investments are collected in cash. The recognition of installment sales gains as of December 31, 2008 are estimates and will not be finally determined until the Company files its 2008 tax return in September 2009. A substantial portion of these installment gains as of December 31, 2008 will be recognized for tax purposes in 2009 as certain notes received from the sale of the related investments have been sold.

The Company's undistributed book earnings of \$184.7 million as of December 31, 2008 resulted from undistributed ordinary income and long-term capital gains. The difference between undistributed book earnings at the end of the year and taxable income carried over from the current year into the next year relates to a variety of timing and permanent differences in the recognition of income and expenses for book and tax purposes.

The Company's consolidated subsidiary, AC Corp, is subject to federal and state income taxes. For the three months ended June 30, 2009 and 2008, AC Corp's income tax expense was \$2.7 million and \$2.2 million, respectively, and for the six months ended June 30, 2009 and 2008, income tax expense was \$2.3 million and \$1.9 million, respectively. For the six months ended June 30, 2009, paid in capital was decreased by \$2.9 million primarily for the reduction of the deferred tax asset related to stock options that expired unexercised.

**Note 11. Supplemental Disclosure of Cash Flow Information**

The Company paid interest of \$82.8 million and \$77.1 million, respectively, for the six months ended June 30, 2009 and 2008. The Company paid income taxes, including excise taxes (net of refunds), of \$5.5 million and \$13.0 million the six months ended June 30, 2009 and 2008, respectively.

Non-cash operating activities for the six months ended June 30, 2009 and 2008, totaled \$69.4 million and \$99.7 million, respectively. Non-cash operating activities included the exchange of existing debt securities and accrued interest for new debt and equity securities.

Non-cash financing activities included the issuance of common stock in lieu of cash distributions totaling \$3.8 million for the six months ended June 30, 2008.

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Note 12. Financial Highlights

	At and for the Six Months Ended		At and for the
	June 30,		Year Ended
	2009 <sup>(1)</sup>	2008	December 31, 2008
<b>Per Common Share Data</b>			
Net asset value, beginning of period	\$ 9.62	\$ 17.54	\$ 17.54
Net investment income <sup>(2)</sup>	0.26	0.80	1.23
Net realized gains (losses) <sup>(2)(3)</sup>	(0.86)	(0.09)	(0.75)
Net investment income plus net realized gains (losses) <sup>(2)</sup>	(0.60)	0.71	0.48
Net change in unrealized appreciation or depreciation <sup>(2)(3)</sup>	(1.97)	(1.56)	(6.49)
Gain on repurchase of debt	0.46		
Net increase (decrease) in net assets resulting from operations <sup>(2)</sup>	(2.11)	(0.85)	(6.01)
Net decrease in net assets from shareholder distributions		(1.30)	(2.60)
Net increase (decrease) in net assets from capital share transactions <sup>(2)</sup>	(0.02)	0.54	0.69
Net asset value, end of period	\$ 7.49	\$ 15.93	\$ 9.62
Market value, end of period	\$ 3.48	\$ 13.89	\$ 2.69
Total return <sup>(4)</sup>	29.4%	(30.3)%	(82.5)%
<b>Ratios and Supplemental Data</b>			
(\$ and shares in millions, except per share amounts)			
Ending net assets	\$ 1,341.3	\$ 2,845.8	\$ 1,718.4
Common shares outstanding at end of period	179.0	178.7	178.7
Diluted weighted average common shares outstanding	178.7	167.2	173.0
Employee, employee stock option and administrative expenses/average net assets <sup>(5)</sup>	2.87%	2.34%	5.47%
Total operating expenses/average net assets <sup>(5)(6)</sup>	8.93%	4.97%	11.39%
Income tax expense (benefit), including excise tax/average net assets <sup>(5)</sup>	0.15%	0.22%	0.10%
Net investment income/average net assets <sup>(5)</sup>	3.10%	4.74%	8.47%
Net increase (decrease) in net assets resulting from operations/average net assets <sup>(5)</sup>	(25.52)%	(5.08)%	(41.34)%

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Portfolio turnover rate <sup>(5)</sup>	3.31%	12.81%	24.00%
Average debt outstanding	\$ 1,903.6	\$ 2,126.2	\$ 2,091.6
Average debt per share <sup>(2)</sup>	\$ 10.65	\$ 12.71	\$ 12.09

- (1) The results for the six months ended June 30, 2009, are not necessarily indicative of the operating results to be expected for the full year.
- (2) Based on diluted weighted average number of common shares outstanding for the period.
- (3) Net realized gains (losses) and net change in unrealized appreciation or depreciation can fluctuate significantly from period to period. As a result, quarterly comparisons may not be meaningful.
- (4) Total return assumes the reinvestment of all dividends paid for the periods presented.
- (5) The ratios for the six months ended June 30, 2009 and 2008, do not represent annualized results.
- (6) Includes 0.19% for the effect of the impairment of long-lived asset during the six months ended June 30, 2009.

**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 13. Litigation**

On June 23, 2004, the Company was notified by the SEC that the SEC was conducting an informal investigation of the Company. The investigation related to the valuation of securities in the Company's private finance portfolio and other matters. On June 20, 2007, the Company announced that it entered into a settlement with the SEC that resolved the SEC's informal investigation. As part of the settlement and without admitting or denying the SEC's allegations, the Company agreed to the entry of an administrative order. In the order the SEC alleged that, between June 30, 2001, and March 31, 2003, the Company did not maintain books, records and accounts which, in reasonable detail, supported or accurately and fairly reflected valuations of certain securities in the Company's private finance portfolio and, as a result, did not meet certain recordkeeping and internal controls provisions of the federal securities laws. In the administrative order, the SEC ordered the Company to continue to maintain certain of its current valuation-related controls. Specifically, for a period of two years, the Company has undertaken to: (1) continue to employ a Chief Valuation Officer, or a similarly structured officer-level employee, to oversee its quarterly valuation processes; and (2) continue to employ third-party valuation consultants to assist in its quarterly valuation processes.

On December 22, 2004, the Company received letters from the U.S. Attorney for the District of Columbia requesting the preservation and production of information regarding the Company and Business Loan Express, LLC (currently known as Ciena Capital LLC) in connection with a criminal investigation relating to matters similar to those investigated by and settled with the SEC as discussed above. The Company produced materials in response to the requests from the U.S. Attorney's office and certain current and former employees were interviewed by the U.S. Attorney's Office. The Company has voluntarily cooperated with the investigation.

In late December 2006, the Company received a subpoena from the U.S. Attorney for the District of Columbia requesting, among other things, the production of records regarding the use of private investigators by the Company or its agents. The Board established a committee, which was advised by its own counsel, to review this matter. In the course of gathering documents responsive to the subpoena, the Company became aware that an agent of the Company obtained what were represented to be telephone records of David Einhorn and which purport to be records of calls from Greenlight Capital during a period of time in 2005. Also, while the Company was gathering documents responsive to the subpoena, allegations were made that the Company's management had authorized the acquisition of these records and that management was subsequently advised that these records had been obtained. The Company's management has stated that these allegations are not true. The Company has cooperated fully with the inquiry by the U.S. Attorney's Office.

On February 26, 2007, Dana Ross filed a class action complaint in the U.S. District Court for the District of Columbia in which she alleges that Allied Capital Corporation and certain members of management violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. Thereafter, the court appointed new lead counsel and approved new lead plaintiffs. On July 30, 2007, plaintiffs served an amended complaint. Plaintiffs claim that, between November 7, 2005, and January 22, 2007, Allied Capital either failed to disclose or misrepresented information about its portfolio company, Business Loan Express, LLC. Plaintiffs seek unspecified compensatory and other damages, as well as other relief. The Company believes the lawsuit is without merit, and intends to defend the lawsuit vigorously. On September 13, 2007, the Company filed a motion to dismiss the lawsuit. A hearing was held on the motion to dismiss in April 2009. The motion is pending.



**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 13. Litigation, continued**

On October 6, 2008, Rena Nadoff filed a shareholder derivative action in the Superior Court of the District of Columbia, captioned *Rena Nadoff v. Walton, et al.*, 2008 CA 007108, seeking unspecified compensatory and other damages, as well as equitable relief on behalf of Allied Capital Corporation. Ms. Nadoff's suit is substantially similar to a derivative action she filed in February 2007, which the Court dismissed in July 2007. On November 26, 2008, the Company filed a motion to dismiss the second Nadoff lawsuit. On February 3, 2009, the Court denied the motion to dismiss but ordered Ms. Nadoff to file an amended complaint that clearly identifies and sets forth the breaches of fiduciary duty, if any, that are alleged to have occurred after the filing (or dismissal) of the first Nadoff derivative lawsuit. Ms. Nadoff filed an amended complaint alleging breaches of fiduciary duty by the Board of Directors. The Company filed a motion to dismiss the amended complaint. In response, Ms. Nadoff requested that she be allowed to voluntarily dismiss the amended complaint. On May 21, 2009, the Court granted the motion and dismissed the amended complaint.

In addition, the Company is party to certain lawsuits in the normal course of business. Furthermore, third parties may try to seek to impose liability on the Company in connection with the activities of its portfolio companies. For a discussion of civil investigations being conducted regarding the lending practice of Ciena Capital LLC, a portfolio company of the Company, see Note 3, Portfolio Ciena Capital LLC.

While the outcome of any of the open legal proceedings described above cannot at this time be predicted with certainty, the Company does not expect these matters will materially affect its financial condition or results of operations.

**Note 14. Subsequent Events**

During the third quarter of 2009, the Company repaid \$100.0 million of its Private Notes at par. In addition, on July 17, 2009, the aggregate commitments under the Company's Revolving Line of Credit were reduced to \$115.0 million.

In accordance with SFAS 165, the Company has evaluated events subsequent to June 30, 2009, and through the issuance of these consolidated financial statements, which occurred on August 10, 2009.



**Report of Independent Registered Public Accounting Firm**

**The Board of Directors and Shareholders**

**Allied Capital Corporation:**

We have reviewed the accompanying consolidated balance sheet of Allied Capital Corporation and subsidiaries (the Company), including the consolidated statement of investments, as of June 30, 2009, the related consolidated statements of operations for the three- and six-month periods ended June 30, 2009 and 2008, and the consolidated statements of changes in net assets and cash flows and the financial highlights (included in Note 12) for the six-month periods ended June 30, 2009 and 2008. These consolidated financial statements and financial highlights are the responsibility of the Company's management.

We conducted our reviews in accordance with standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the consolidated financial statements and financial highlights referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Allied Capital Corporation and subsidiaries, including the consolidated statement of investments, as of December 31, 2008, and the related consolidated statements of operations, changes in net assets and cash flows (not presented herein), and the financial highlights, for the year then ended; and in our report dated March 2, 2009, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet including the consolidated statement of investments as of December 31, 2008, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

Note 1 of the Company's audited financial statements as of December 31, 2008, and for the year then ended, discloses that the Company was in default on provisions of certain credit agreements at December 31, 2008. Our auditors' report on those financial statements dated March 2, 2009, includes an explanatory paragraph referring to the matters in Note 1 of those financial statements, and indicating that these matters raised substantial doubt about the Company's ability to continue as a going concern. As indicated in Note 1 of the Company's unaudited interim financial statements as of June 30, 2009, the Company was still in default on provisions of certain credit agreements as of June 30, 2009. The accompanying interim financial information does not include any adjustments that might result from the outcome of this uncertainty.

Washington, D.C.

August 10, 2009

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## SCHEDULE OF INVESTMENTS IN AND ADVANCES TO AFFILIATES

PRIVATE FINANCE Portfolio Company	Investment <sup>(1)</sup>	Amount of Interest or Dividends Credited to		December	Gross Additions <sup>(3)</sup>	Gross Reductions <sup>(4)</sup>	June 30,
		Income <sup>(6)</sup>	Other <sup>(2)</sup>	31, 2008			Value
(in thousands)							
<b>Companies More Than 25% Owned</b>							
AGILE Fund I, LLC (Private Equity Fund)	Equity Interests			\$ 497	\$ 34	\$ (105)	\$ 426
AllBridge Financial, LLC (Asset Management)	Senior Loan Equity Interests	\$ 6		10,960	398 1,673	(4,586)	398 8,047
Allied Capital Senior Debt Fund, L.P. (Private Debt Fund)	Limited Partnership Interests			31,800	1,244		33,044
Avborne, Inc. (Business Services)	Preferred Stock Common Stock			942		(38)	904
Avborne Heavy Maintenance, Inc. (Business Services)	Common Stock						
Aviation Properties Corporation (Business Services)	Common Stock						
Border Foods, Inc. (Consumer Products)	Senior Loan Preferred Stock Common Stock	2,704		33,027 11,851	2,340	(491) (390)	34,876 11,461
Calder Capital Partners, LLC (Asset Management)	Senior Loan <sup>(5)</sup> Equity Interests			953	27		980
Callidus Capital Corporation	Subordinated Debt	1,474		16,068	859		16,927

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(Asset Management)	Common Stock			34,377		(13,365)	21,012
Ciena Capital LLC (Financial Services)	Senior Loan <sup>(5)</sup>			104,883		(11,840)	93,043
	Class B Equity Interests				3,504	(3,504)	
	Class C Equity Interests						
CitiPostal Inc. (Business Services)	Senior Loan	16		681	1		682
	Unitranche Debt	3,145		51,548	282	(461)	51,369
	Subordinated Debt	778		9,114	752		9,866
	Common Stock			8,616		(8,616)	
Coverall North America, Inc. (Business Services)	Unitranche Debt	1,932		31,948	16	(408)	31,556
	Subordinated Debt	430		5,549	3		5,552
	Common Stock			17,968	4,642		22,610
CR Holding, Inc. (Consumer Products)	Subordinated Debt <sup>(5)</sup>			17,360	1,316	(7,966)	10,710
	Common Stock						
Crescent Equity Corp. (Business Services)	Senior Loan	22		433			433
	Subordinated Debt <sup>(5)</sup>	58	\$ 63	18,614		(14,236)	4,378
	Common Stock			4,580	1,939	(6,519)	
Direct Capital Corporation (Financial Services)	Senior Loan <sup>(5)</sup>				8,405		8,405
	Subordinated Debt <sup>(5)</sup>			13,530		(6,421)	7,109
	Common Stock						
Financial Pacific Company (Financial Services)	Subordinated Debt	5,373		62,189	20	(12,513)	49,696
	Preferred Stock	10					
	Common Stock						
ForeSite Towers, LLC (Tower Leasing)	Equity Interest			889		(889)	
Global Communications, LLC (Business Services)	Senior Loan <sup>(5)</sup>			1,335		(343)	992
Hot Light Brands, Inc. (Retail)	Senior Loan <sup>(5)</sup>			13,678	50	(1,718)	12,010
	Common Stock						
Hot Stuff Foods, LLC (Consumer Products)	Senior Loan	1,062		42,378	11,100	(2,820)	50,658
	Subordinated Debt <sup>(5)</sup>				16,143		16,143
	Common Stock						
Huddle House, Inc. (Retail)	Subordinated Debt	4,185		57,067	897	(38,535)	19,429
	Common Stock			20,922		(2,511)	18,411

IAT Equity, LLC and Affiliates	Subordinated Debt	272	6,000		6,000
d/b/a Industrial Air Tool (Industrial Products)	Equity Interests		8,860	390	9,250

See related footnotes at the end of this schedule.

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<b>PRIVATE FINANCE</b>		Amount of Interest or Dividends		December	Gross	Gross	June 30,
<b>Portfolio Company</b>		Credited	to	31,			2009
(in thousands)	Investment <sup>(1)</sup>	Income <sup>(6)</sup>	Other <sup>(2)</sup>	2008	Additions <sup>(3)</sup>	Reductions <sup>(4)</sup>	Value
				Value			Value
Impact Innovations Group, LLC (Business Services)	Equity Interests in Affiliate			\$ 321	\$ 1	\$	\$ 322
Insight Pharmaceuticals Corporation (Consumer Products)	Subordinated Debt	\$ 3,536		63,359	8,910	(18,219)	54,050
	Preferred Stock			4,068	20,932	(25,000)	
	Common Stock				34,088	(23,055)	11,033
Jakel, Inc. (Industrial Products)	Subordinated Debt <sup>(5)</sup>			374			374
Knightsbridge CLO 2007-1 Ltd. (CLO)	Class E Notes	984		14,866		(3,525)	11,341
	Income Notes	1,530		35,214	1,529	(10,885)	25,858
Knightsbridge CLO 2008-1 Ltd. (CLO)	Class C Notes	578		12,800		(627)	12,173
	Class D Notes	402		8,000		(1,015)	6,985
	Class E Notes	737		10,573	306	(1,983)	8,896
	Income Notes	1,990		21,315	1,990	(5,026)	18,279
MHF Logistical Solutions, Inc. (Business Services)	Subordinated Debt <sup>(5)</sup>				49,633	(49,633)	
	Preferred Stock						
	Common Stock				20,942	(20,942)	
MVL Group, Inc. (Business Services)	Senior Loan	1,669		30,663	70	(5,477)	25,256
	Subordinated Debt	2,552		40,994	42,120	(49,271)	33,843
	Subordinated Debt <sup>(5)</sup>			86	144	(230)	
	Common Stock						
Old Orchard Brands, LLC (Consumer Products)	Subordinated Debt	917		18,882	262	(19,144)	
	Equity Interests			27,763		(27,763)	
Penn Detroit Diesel Allison, LLC (Business Services)	Subordinated Debt	2,767		37,869	578	(38,447)	
	Equity Interests			21,100	1,262	(2,357)	20,005
Senior Secured Loan Fund LLC (Private Debt Fund)	Subordinated Certificates	5,896	\$ 6,503	125,423	47,373	(18,596)	154,200
	Equity Interests			1		(1)	

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Service Champ, Inc. (Business Services)	Subordinated Debt Common Stock	2,138	26,984 21,156	353 1,520		27,337 22,676
Stag-Parkway, Inc. (Business Services)	Subordinated Debt Unitranche Debt Common Stock	871 170	17,962 6,968	18,997 418	(18,380) (1,018)	18,997 5,950
Startec Equity, LLC (Telecommunications)	Equity Interests		332		(332)	
Worldwide Express Operations, LLC (Business Services)	Subordinated Debt <sup>(5)</sup> Equity Interests Warrants	38	2,032	3 300	(1,116) (300)	919
<b>Total companies more than 25% owned</b>			<b>\$ 1,187,722</b>			<b>\$ 1,014,871</b>
<b>Companies 5% to 25% Owned</b>						
10th Street, LLC (Business Services)	Subordinated Debt Equity Interests Option	\$ 1,424	\$ 21,439 975 25	\$ 448	\$ (10) (470)	\$ 21,877 505 25
Advantage Sales & Marketing, Inc. (Business Services)	Subordinated Debt Equity Interests	2,286	135,000 5,000		(135,000) (5,000)	
Air Medical Group Holdings LLC (Healthcare Services)	Senior Loan Equity Interests	60	3,139 10,800	9,491 1,673	(12,630)	12,473
Alpine ESP Holdings, Inc. (Business Services)	Preferred Stock Common Stock			701 13	(701) (13)	
Amerex Group, LLC (Consumer Products)	Subordinated Debt Equity Interests	1,993 6,167	8,784 9,932	5	(8,789) (9,932)	
BB&T Capital Partners/Windsor Mezzanine Fund, LLC (Private Equity Fund)	Equity Interests		11,063		(1,383)	9,680
Becker Underwood, Inc. (Industrial Products)	Subordinated Debt Common Stock	425	25,502 2,267	216 2,748	(25,718) (5,015)	
Drew Foam Companies, Inc. (Business Services)	Preferred Stock Common Stock		512	111 6	(623) (6)	

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Driven Brands, Inc. (Consumer Services)	Subordinated Debt	7,216	83,698	3,727	(3,393)	84,032
	Common Stock		4,855		(2,655)	2,200
Hilden America, Inc. (Consumer Products)	Common Stock		76	378	(454)	

See related footnotes at the end of this schedule.

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<b>PRIVATE FINANCE Portfolio Company</b>		Amount of Interest or Dividends Credited to	December 31, 2008 Value	Gross Additions <sup>(3)</sup>	Gross Reductions <sup>(4)</sup>	June 30, 2009 Value
<b>(in thousands)</b>	<b>Investment<sup>(1)</sup></b>	Income <sup>(6)</sup> Other <sup>(2)</sup>				
Lydall Transport, Ltd. (Business Services)	Equity Interests		\$ 345	\$ 87	\$ (432)	\$
Multi-Ad Services, Inc. (Business Services)	Unitranche Debt Equity Interests	\$ 159	2,941 1,782	13	(501) (535)	2,453 1,247
Pendum Acquisition, Inc. (Business Services)	Common Stock					
Postle Aluminum Company, LLC (Industrial Products)	Senior Loan <sup>(5)</sup> Subordinated Debt <sup>(5)</sup> Equity Interest			34,876 23,868	(20,507) (23,868)	14,369
Progressive International Corporation (Consumer Products)	Preferred Stock Common Stock  Warrants		1,125 4,600	46	(700)	1,171 3,900
Regency Healthcare Group, LLC (Healthcare Services)	Senior Loan Unitranche Debt Equity Interests	44 309	10,825 2,050	4,001 31	(4,001) (10,856) (233)	1,817
SGT India Private Limited (Business Services)	Common Stock			5	(5)	
Soteria Imaging Services, LLC (Healthcare Services)	Subordinated Debt Equity Interests	265	4,054 1,971	41	(456)	4,095 1,515
Triax Holdings, LLC (Consumer Products)	Subordinated Debt <sup>(5)</sup> Equity Interests			10,772 15,739	(10,772) (15,730)	9
Universal Environmental Services, LLC (Business Services)	Equity Interests					
<b>Total companies 5% to 25% owned</b>			<b>\$ 352,760</b>			<b>\$ 161,368</b>



This schedule should be read in conjunction with the Company's consolidated financial statements, including the consolidated statement of investments and Note 3 to the consolidated financial statements. Note 3 includes additional information regarding activities in the private finance portfolio.

- (1) Common stock, preferred stock, warrants, options, and equity interests are generally non-income producing and restricted. The principal amount for loans and debt securities and the number of shares of common stock and preferred stock is shown in the consolidated statement of investments as of June 30, 2009.
- (2) Other includes interest, dividend, or other income which was applied to the principal of the investment and therefore reduced the total investment. These reductions are also included in the Gross Reductions for the investment, as applicable.
- (3) Gross additions include increases in the cost basis of investments resulting from new portfolio investments, paid-in-kind interest or dividends, the amortization of discounts and closing fees, the exchange of one or more existing securities for one or more new securities and the movement of an existing portfolio company into this category from a different category. Gross additions also include net increases in unrealized appreciation or net decreases in unrealized depreciation.
- (4) Gross reductions include decreases in the cost basis of investments resulting from principal collections related to investment repayments or sales, the exchange of one or more existing securities for one or more new securities and the movement of an existing portfolio company out of this category into a different category. Gross reductions also include net increases in unrealized depreciation or net decreases in unrealized appreciation.
- (5) Loan or debt security is on non-accrual status at June 30, 2009, and is therefore considered non-income producing. Loans or debt securities on non-accrual status at the end of the period may or may not have been on non-accrual status for the full period.
- (6) Represents the total amount of interest or dividends credited to income for the portion of the year an investment was included in the companies more than 25% owned or companies 5% to 25% owned categories, respectively.

## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*The following analysis of the financial condition and results of operations of the Company should be read in conjunction with the Company's Consolidated Financial Statements and the Notes thereto included herein and in the Company's annual report on Form 10-K for the year ended December 31, 2008. In addition, this quarterly report on Form 10-Q contains 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 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 below in the Risk Factors section. Other factors that could cause actual results to differ materially include:*

*changes in the economy, including economic downturns or recessions;*

*risks associated with possible disruption in our operations due to terrorism;*

*future changes in laws or regulations or changes in accounting principles; 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**

We are a business development company, or BDC, in the private equity business and we are internally managed. Specifically, we primarily invest in private middle market companies in a variety of industries through long-term debt and equity capital instruments. Our financing generally is used to fund buyouts, acquisitions, growth, recapitalizations, note purchases, and other types of financings. Our investment objective is to achieve current income and capital gains.

The United States and the global economies continue to operate in an unprecedented economic recession and the U.S. capital markets continue to experience volatility and a severe lack of liquidity. In addition, events of default have occurred and are continuing under our revolving line of credit and private notes related to certain financial and other covenants. See Financial Condition, Liquidity and Capital Resources. Our strategy in these difficult economic times has been focused on reducing costs and streamlining our organization; building liquidity through selected asset sales; retaining capital by limiting new investment activity and suspending dividend payments; and working with portfolio companies to help them position for growth when the economy recovers.

Our portfolio composition at June 30, 2009 and 2008, and December 31, 2008, was as follows:

	<b>June 30,</b>		<b>December</b>
	<b>2009</b>	<b>2008</b>	<b>31,</b>
			<b>2008</b>
Private finance	97 %	98%	97%
Commercial real estate finance	3 %	2%	3%

Our earnings primarily depend 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 primarily 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. The level of fee income is primarily related to the level of new investment activity and the level of fees earned from portfolio companies and managed funds. The level of investment activity can vary substantially from period to period depending on many factors, including the general economic environment, the amount of debt and equity capital available to middle market companies, the level of merger and acquisition activity for such companies, the competitive environment for the types of investments we make and our ability to secure debt and equity capital for our investment activities.

In addition to managing our own assets, we manage certain funds that also invest in the debt and equity securities of primarily private middle market companies in a variety of industries. At June 30, 2009, we had eight separate funds under our management (together, the Managed Funds) for which we may earn management or other fees for our services. We may invest in the equity of these funds, along with other third parties, from which we may earn a current return and/or a future incentive allocation. At June 30, 2009, the Managed Funds had total assets of approximately \$3.4 billion. See [Managed Funds](#) below for further discussion.

In aggregate, including the total assets on our balance sheet and assets under management in our Managed Funds, we had \$6.6 billion in managed assets at June 30, 2009.

In addition to the funds we already manage or co-manage, we may pursue additional managed fund opportunities including the potential acquisition of asset managers. These potential funds may be focused on all levels of a middle market company's capital structure, from senior debt through equity capital, or on commercial real estate investing. There can be no assurance that these new fund raising initiatives will result in additional funds under management.

## PORTFOLIO AND INVESTMENT ACTIVITY

The total portfolio at value, investment activity, and the yield on interest-bearing investments at and for the three and six months ended June 30, 2009 and 2008, and at and for the year ended December 31, 2008, were as follows:

(\$ in millions)	At and for the Three Months Ended June 30,		At and for the Six Months Ended June 30,		At and for the Year Ended December 31,
	2009	2008	2009	2008	2008
Portfolio at value	\$ 2,550.0	\$ 4,497.6	\$ 2,550.0	\$ 4,497.6	\$ 3,493.0
Investments funded	\$ 62.1	\$ 318.9	\$ 98.7	\$ 594.0	\$ 1,078.2
Payment-in-kind interest and dividends, net of cash collections	\$ 10.9	\$ 11.1	\$ 18.5	\$ 24.5	\$ 53.4
Principal collections related to investment repayments or sales <sup>(1)</sup>	\$ 345.5	\$ 332.8	\$ 587.3	\$ 597.6	\$ 1,037.3
Yield on interest-bearing portfolio investments <sup>(2)</sup>	11.8%	12.7%	11.8%	12.7%	12.1%

<sup>(1)</sup> Principal collections related to investment repayments or sales for the three and six months ended June 30, 2009, included \$38.8 million and \$171.0 million, respectively, of cash collections related to notes and other receivables received from the sale of investments in portfolio companies in prior periods. Principal collections related to investment repayments or sales for the three and six months ended June 30, 2009 and 2008, and year ended

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December 31, 2008, included collections of \$9.7 million, \$274.9 million, \$9.7 million, \$303.9 million and \$383.0 million, respectively, related to the sale of loans to certain of our Managed Funds.

- (2) 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, plus the effective interest yield on the preferred shares/income notes of CLOs, plus the annual stated interest on the subordinated certificates in the Senior Secured Loan Fund LLC 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 interest bearing investments at and for the three and six months ended June 30, 2009 and 2008, and at and for the year ended December 31, 2008, were as follows:

	At and for the Three Months				At and for the Six Months				At and for the Year
	Ended June 30,		Ended June 30,		Ended June 30,		Ended June 30,		December 31,
	2009	2008	2009	2008	2009	2008	2009	2008	
	Value	Yield <sup>(1)</sup>	Value	Yield <sup>(1)</sup>	Value	Yield <sup>(1)</sup>	Value	Yield <sup>(1)</sup>	Value
Value:									
Debt securities:									
at value	\$ 287.1	4.9%	\$ 330.9	6.4%	\$ 287.1	4.9%	\$ 330.9	6.4%	\$ 306.6
debt	376.7	12.2%	627.6	12.2%	376.7	12.2%	627.6	12.2%	456.6
total	1,186.6	13.8%	2,292.0	13.7%	1,186.6	13.8%	2,292.0	13.7%	1,829.8
Preferred debt securities:									
at value	1,850.4	12.1%	3,250.5	12.6%	1,850.4	12.1%	3,250.5	12.6%	2,591.1
preferred shares/income notes of CLOs	82.1	11.1%	232.6	16.0%	82.1	11.1%	232.6	16.0%	179.1
subordinated certificates in Senior Secured Loan Fund LLC <sup>(2)</sup>	154.2	10.0%	94.6	10.2%	154.2	10.0%	94.6	10.2%	125.1
other debt securities	389.6		813.1		389.6		813.1		502.1
total	625.9		1,140.3		625.9		1,140.3		807.1
at value	\$ 2,476.3		\$ 4,390.8		\$ 2,476.3		\$ 4,390.8		\$ 3,399.1
total	\$ 61.3 <sup>(4)</sup>		\$ 317.2		\$ 96.9 <sup>(4)</sup>		\$ 591.8		\$ 1,068.1
of cash collections	\$ 10.9		\$ 11.1		\$ 18.5		\$ 24.3		\$ 53.1
of cash collections related to CLOs	\$ 341.0		\$ 324.5		\$ 581.7		\$ 580.9		\$ 1,020.1

(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 on the preferred shares/income notes of CLOs is calculated as the (a) effective interest yield on the preferred shares/income notes of CLOs, divided by (b) preferred shares/income notes of CLOs at value. The weighted average yield on the subordinated certificates in the Senior Secured Loan Fund LLC is computed as the (a) annual stated interest divided by (b) total investment at value. The weighted average yields are computed as of the balance sheet date.

(2) Investments in the preferred shares/income notes of CLOs and the subordinated certificates in the Senior Secured Loan Fund LLC earn a current return that is included in interest income in the consolidated statement of operations.

- (3) Includes \$38.8 million and \$171.0 million, respectively, cash collections during the three and six months ended June 30, 2009, related to notes and other receivables received from the sale of investments in prior periods. Also includes collections from the sale or repayment of senior loans totaling \$39.0 million, \$64.2 million, \$75.6 million, \$124.2 million and \$285.3 million, respectively, for the three and six months ended June 30, 2009 and 2008, and for the year ended December 31, 2008.
- (4) Includes \$7.6 million and \$28.1 million, respectively, funded under pre-existing commitments under revolving lines of credit during the three and six months ended June 30, 2009. During the three and six months ended June 30, 2009, a total of \$12.5 million and \$28.3 million, respectively, was repaid under these arrangements, which is included in principal collections related to investment repayments or sales.

Our private finance portfolio primarily is composed of debt and equity investments. Debt investments include senior loans, unitranche debt (an instrument that combines both senior and subordinated financing, generally in a first lien position), or subordinated debt (with or without equity features). The junior debt that we have in the portfolio is lower in repayment priority than senior debt and is also known as mezzanine debt. Our portfolio contains equity investments for a minority equity stake in portfolio companies and includes equity features such as nominal cost warrants received in conjunction with our debt investments. 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.

**Investment Activity.** Investments funded and the weighted average yield on interest-bearing investments funded for the six months ended June 30, 2009 and 2008, and for the year ended December 31, 2008, consisted of the following:

(\$ in millions)	For the Six Months Ended June 30, 2009					
	Debt Investments		Buyout Investments		Total	
	Amount	Weighted Average Yield <sup>(1)</sup>	Amount	Weighted Average Yield <sup>(1)</sup>	Amount	Weighted Average Yield <sup>(1)</sup>
Loans and debt securities:						
Senior loans	\$ 27.0	6.6%	\$ 8.6	0.3%	\$ 35.6	5.1%
Unitranche debt	1.0	9.5%			1.0	9.5%
Subordinated debt	3.0	15.0%			3.0	15.0%
Total loans and debt securities	31.0	7.5%	8.6	0.3%	39.6	5.9%
Subordinated certificates in Senior Secured Loan Fund LLC <sup>(2)</sup>	47.4	8.4%			47.4	8.4%
Equity	5.1		4.8		9.9	
Total	\$ 83.5		\$ 13.4		\$ 96.9	

(\$ in millions)	For the Six Months Ended June 30, 2008					
	Debt Investments		Buyout Investments		Total	
	Amount	Weighted Average Yield <sup>(1)</sup>	Amount	Weighted Average Yield <sup>(1)</sup>	Amount	Weighted Average Yield <sup>(1)</sup>
Loans and debt securities:						
Senior loans	\$ 111.8	7.0%	\$ 11.6	6.1%	\$ 123.4	6.9%
Unitranche debt <sup>(3)</sup>	14.8	10.5%	0.5	6.6%	15.3	10.4%
Subordinated debt	240.7 <sup>(4)</sup>	12.6%	31.3	14.2%	272.0	12.8%
Total loans and debt securities	367.3	10.8%	43.4	12.0%	410.7	10.9%
Preferred shares/income notes of CLOs <sup>(5)</sup>	27.2	17.8%			27.2	17.8%
Subordinated certificates in Senior Secured Loan Fund LLC <sup>(2)</sup>	93.8	10.9%			93.8	10.9%
Equity	29.5		30.6		60.1	
Total	\$ 517.8		\$ 74.0		\$ 591.8	

**For the Year Ended December 31, 2008**

<b>Debt Investments</b>	<b>Total</b>
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(\$ in millions)	Amount	Weighted Average Yield <sup>(1)</sup>	Buyout Investments		Amount	Weighted Average Yield <sup>(1)</sup>
			Amount	Weighted Average Yield <sup>(1)</sup>		
Loans and debt securities:						
Senior loans	\$ 175.9	7.4%	\$ 13.9	5.4%	\$ 189.8	7.2%
Senior secured loan to Ciena Capital LLC			319.0	0.0% <sup>(6)</sup>	319.0	0.0% <sup>(6)</sup>
Unitranche debt <sup>(3)</sup>	15.3	10.5%	0.5	6.6%	15.8	10.4%
Subordinated debt	246.4 <sup>(4)</sup>	12.6%	54.8	15.4%	301.2	13.1%
Total loans and debt securities	437.6	10.4%	388.2	2.4%	825.8	6.6% <sup>(7)</sup>
Preferred shares/income notes of CLOs <sup>(5)</sup>	35.6	18.6%			35.6	18.6%
Subordinated certificates in Senior Secured Loan Fund LLC <sup>(2)</sup>	124.7	10.9%			124.7	10.9%
Equity	40.5		41.5		82.0	
Total	\$ 638.4		\$ 429.7		\$ 1,068.1	

(1) The weighted average yield on interest-bearing investments is computed as the (a) annual stated interest on accruing interest-bearing investments, divided by (b) total interest-bearing investments funded. The weighted average yield on the preferred shares/income notes of CLOs is calculated as the (a) effective interest yield on the preferred shares/income notes of CLOs, divided by (b) preferred shares/income notes of CLOs funded. The weighted average yield on the subordinated certificates in the Senior Secured Loan Fund LLC is computed as the (a) annual stated interest divided by (b) total investment at value. The weighted average yield is calculated using yields as of the date an investment is funded.

(2) In June 2009, the Unitranche Fund LLC was renamed the Senior Secured Loan Fund LLC.

(3) Unitranche debt is an investment that combines both senior and subordinated financing, generally in a first lien position. The yield on a unitranche investment reflects the blended yield of senior and subordinated debt.

- (4) Subordinated debt investments for the six months ended June 30, 2008, and year ended December 31, 2008, included \$41.1 million and \$43.8 million, respectively, in investments in the bonds of collateralized loan obligations (CLOs). Certain of these CLOs are managed by Callidus Capital Corporation (Callidus), a portfolio company controlled by us. These CLOs primarily invest in senior corporate loans.
- (5) CLO equity investments included preferred shares/income notes of CLOs that primarily invest in senior corporate loans. Certain of these CLOs are managed by us or by Callidus.
- (6) The senior secured loan to Ciena Capital LLC was acquired on September 30, 2008, and was placed on non-accrual status on the purchase date.
- (7) Excluding the senior secured loan to Ciena, the weighted average yield on new investments for the year ended December 31, 2008 was 10.8%.

For the six months ended June 30, 2009, we made private finance investments totaling \$96.9 million. Investments arose primarily from fundings under pre-existing investment commitments, including fundings under revolving line of credit instruments and \$47.4 million to fund investments made by the Senior Secured Loan Fund LLC.

Historically, our focus for investments generally has been on higher return junior debt capital investments. Senior loans funded by us generally were funded with the intent to sell the loan or for the portfolio company to refinance the loan at some point in the future as discussed below. We have made fewer direct unitranche debt investments since the establishment of the Senior Secured Loan Fund LLC (formerly, the Unitranche Fund LLC) in the fourth quarter of 2007. Unitranche loans sourced by us generally are referred to the Senior Secured Loan Fund. Since its inception, we have invested \$172.8 million in the Senior Secured Loan Fund, which supported its closing of investments totaling \$0.9 billion. The 10.0% effective yield on the subordinated certificates in the Senior Secured Loan Fund at June 30, 2009, represents the contractual coupon on the subordinated certificates and excludes any return from potential future excess cash flows from portfolio earnings available to the subordinated certificate holders and from related structuring fees and management and sourcing fees. See [Managed Funds](#) below.

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.

We may underwrite or arrange senior loans related to our portfolio investments or for other companies that are not in our portfolio. When we underwrite or arrange senior loans, we may earn a fee for such activities. Senior loans underwritten or arranged by us may 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 the Managed Funds or funds managed by Callidus Capital Corporation (Callidus), a portfolio company controlled by us. After completing loan sales, we may retain a position in these senior loans. We generally earn a fee on the senior loans we underwrite or arrange whether or not we fund the underwritten commitment. 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.

We have focused our efforts on selling assets in our portfolio to generate capital. Principal collections related to private finance investment repayments or sales were \$581.7 million for the six months ended June 30, 2009, including \$171.0 million of cash collections related to notes and other receivables received from the sale of investments in portfolio companies in prior periods. Principal collections include repayments of senior debt funded by us that was subsequently sold by us or refinanced or repaid by the portfolio companies. As a result of asset sales during the first six months of 2009, our portfolio mix has shifted to more senior assets. We plan to continue to sell assets and

re-balance our portfolio with an emphasis on current income. However, there can be no assurance that we will be able to achieve these objectives.

**Outstanding Investment Commitments.** At June 30, 2009, we had outstanding private finance investment commitments as follows:

(\$ in millions)	Companies		Companies		Total
	More Than 25% Owned <sup>(1)</sup>	Companies 5% to 25% Owned	Less Than 5% Owned		
Senior loans	\$ 11.1	\$ 12.1	\$ 62.6	\$ 85.8	
Unitranche debt	3.0		11.6	14.6	
Subordinated debt	18.9	4.2		23.1	
Total loans and debt securities	33.0	16.3	74.2	123.5 <sup>(2)</sup>	
Senior Secured Loan Fund	352.2			352.2	
Equity securities	19.6	7.0	34.8	61.4 <sup>(3)</sup>	
Total	\$ 404.8	\$ 23.3	\$ 109.0	\$ 537.1	

(1) Includes a \$4.0 million revolving line of credit commitment for working capital to Callidus Capital Corporation (Callidus), a portfolio company controlled by us, which owns 100% of Callidus Capital Management, LLC, an asset management company that structures and manages collateralized loan obligations (CLOs), collateralized debt obligations (CDOs), and other related investments.

(2) Includes \$94.5 million in the form of revolving debt facilities to 22 companies.

(3) Includes \$40.7 million to 10 private equity and venture capital funds. These fund commitments are generally drawn over a multi-year period of time as the funds make investments.

Total commitments were \$537.1 million at June 30, 2009, which included \$352.2 million in commitments to the Senior Secured Loan Fund (see *Managed Funds* ). Investments made by the Senior Secured Loan Fund must be approved by the investment committee of the Senior Secured Loan Fund, which includes a representative from us and GE. Therefore, our commitment to the Senior Secured Loan Fund cannot be drawn without our approval.

In addition to these outstanding investment commitments at June 30, 2009, we also had commitments to private finance portfolio companies in the form of standby letters of credit and guarantees. See *Financial Condition, Liquidity and Capital Resources* below. We intend to fund these commitments with existing cash and through cash flows from operations before new investments, although there can be no assurance that we will generate sufficient cash flows to satisfy these commitments.

**Net Unrealized Depreciation on Private Finance Portfolio.** At June 30, 2009, our private finance portfolio totaled \$4.3 billion at cost and \$2.5 billion at value, which included net unrealized depreciation of \$1.8 billion. \$1.1 billion or 62.3% of the total net unrealized depreciation of \$1.8 billion was related to our investments in four portfolio companies and our investment in CLO/CDO Assets as follows: \$454.5 million or 25.6% related to our investment in Ciena Capital, LLC; \$223.3 million or 12.6% related to investments in CLO/CDO Assets; \$186.8 million or 10.5% related to our investment in EarthColor, Inc.; \$123.4 million or 7.0% related to our investment in Hot Stuff Foods, LLC; and \$118.2 million or 6.7% related to our investment in WMA Equity Corporation and Affiliates.

**Investments in Collateralized Loan Obligations and Collateralized Debt Obligations (CLO/CDO Assets).** At both June 30, 2009, and December 31, 2008, we had investments in CLO issuances and a CDO bond, which totaled as follows:

(\$ in millions)	Cost	2009 Value	Yield <sup>(1)</sup>	Cost	2008 Value	Yield <sup>(1)</sup>
CLO/CDO bonds <sup>(2)</sup>	\$ 129.4	\$ 71.4	13.2%	\$ 127.7	\$ 86.1	18.5%
Preferred shares/income notes of CLOs	247.5	82.1	11.1%	248.2	179.2	16.4%
Total	\$ 376.9	\$ 153.5		\$ 375.9	\$ 265.3	
Percentage of total assets		4.8%			7.1%	

<sup>(1)</sup> The weighted average yield is calculated as the (a) annual stated interest or the effective interest yield on the accruing bonds or the effective interest yield on the preferred shares/income notes, divided by (b) CLO and CDO assets at value. The market yield used in the valuation of the CLO and CDO assets may be different than the interest yields shown above. See discussion below.

<sup>(2)</sup> Included in private finance subordinated debt.

The CLO and CDO issuances in which we have invested are primarily invested in senior corporate loans. Certain of these funds are managed by Callidus, and certain of these funds are managed by us. See also Note 3, Portfolio from our Notes to the Consolidated Financial Statements included in Item 1.

The initial yields on the cost basis of the CLO preferred shares and income notes are based on the estimated future cash flows expected to be paid to these CLO classes from the underlying collateral assets. As each CLO preferred share or income note ages, the estimated future cash flows are updated based on the estimated performance of the underlying collateral assets, and the respective yield on the cost basis is adjusted as necessary. As future cash flows are subject to uncertainties and contingencies that are difficult to predict and are subject to future events that may alter current assumptions, no assurance can be given that the anticipated yields to maturity will be achieved.

The CLO/CDO Assets in which we have invested are junior in priority for payment of interest and principal to the more senior notes issued by the CLOs and CDO. Cash flow from the underlying collateral assets in the CLOs and CDO generally is allocated first to the senior bonds in order of priority, then any remaining cash flow is generally distributed to the preferred shareholders and income note holders. To the extent there are ratings downgrades, defaults and unrecoverable losses on the underlying collateral assets that result in reduced cash flows, the preferred shares/income notes will bear this loss first and then the subordinated bonds would bear any loss after the preferred shares/income notes. At both June 30, 2009, and December 31, 2008, the face value of the CLO/CDO Assets held by us was subordinate to as much as 94% of the face value of the securities outstanding in these CLOs and CDO.

At June 30, 2009, and December 31, 2008, the underlying collateral assets of these CLO and CDO issuances, consisting primarily of senior corporate loans, were issued by 649 issuers and 658 issuers, respectively, and had balances as follows:

(\$ in millions)	2009	2008
Bonds	\$ 233.8	\$ 268.3
Syndicated loans	4,456.8	4,477.3
Cash <sup>(1)</sup>	99.4	89.6
Total underlying collateral assets at cost <sup>(2)</sup>	\$ 4,790.0	\$ 4,835.2

(1) Includes undrawn liability amounts.

(2) At June 30, 2009, and December 31, 2008, the total cost basis of defaulted obligations was \$167.8 million and \$95.0 million, respectively, or approximately 3.5% and 2.0%, respectively, of the total underlying collateral assets.

Throughout 2008, market yields for CLO securities increased. As the market yields for our investments in CLO preferred shares/income notes increased throughout 2008, the fair value of certain of our investments in these assets decreased. At June 30, 2009, the market yield used to value our preferred shares/income notes was 27.5%. Ratings agencies have continued to downgrade the underlying collateral in these types of structures regardless of the payment status of the loan or debt security. In the current economic environment, we expect ratings downgrades, defaults and losses to continue to increase, and we have also considered this in our valuation analysis. Net change in unrealized appreciation or depreciation for the six months ended June 30, 2009, included a net decrease of \$113.1 million related to our investments in CLO/CDO Assets. We received third-party valuation assistance for our investments in the CLO/CDO Assets in each quarter of 2008 and in the first two quarters of 2009. See Results of Operations Valuation Methodology Private Finance below for further discussion of the third-party valuation assistance we received.

As the debt capital markets show significant volatility, yield spreads may widen further. As a result, if the market yields for our investments in CLOs continue to increase, or should the performance of the underlying assets in the CLOs decrease or additional ratings downgrades occur, the fair value of our investments may decrease further.

***Ciena Capital LLC.*** Ciena Capital LLC (Ciena) has provided loans to commercial real estate owners and operators. Ciena has been a participant in the SBA's 7(a) Guaranteed Loan Program, and its wholly-owned subsidiary is licensed by the SBA as a Small Business Lending Company (SBLC). Ciena remains subject to SBA rules and regulations. Ciena is headquartered in New York, NY.

On September 30, 2008, Ciena voluntarily filed for bankruptcy protection under Chapter 11 of Title 11 of the United States Code (the Bankruptcy Code) in the United States Bankruptcy Court for the Southern District of New York (the Court). Ciena continues to operate its servicing business and manage its assets as a debtor-in-possession under the jurisdiction of the Court and in accordance with the applicable provisions of the Bankruptcy Code and the orders of the Court.

As a result of Ciena's decision to file for bankruptcy protection, our unconditional guaranty of the obligations outstanding under Ciena's revolving credit facility became due and, in lieu of paying under our guarantee, we purchased the positions of the senior lenders under Ciena's revolving credit facility. As of June 30, 2009, the senior secured loan to Ciena had a cost basis of \$319.0 million and a value of \$93.0 million. We continue to guarantee the remaining principal balance of \$5 million, plus related interest, fees and expenses payable to a third party bank. In connection with our continuing guaranty of the amounts held by this bank, we have agreed that the amounts owing to the bank under the Ciena revolving credit facility will be paid before any of the secured obligations of Ciena now owed to us.

At June 30, 2009 and December 31, 2008, our investment in Ciena was as follows:

(\$ in millions)	June 30, 2009		December 31, 2008	
	Cost	Value	Cost	Value
Senior Loan	\$ 319.0	\$ 93.0	\$ 319.0	\$ 104.9
Class B Equity Interests <sup>(1)</sup>	119.5		119.5	
Class C Equity Interests <sup>(1)</sup>	109.1		109.3	
Total <sup>(2)</sup>	\$ 547.6	\$ 93.0	\$ 547.8	\$ 104.9

<sup>(1)</sup> At June 30, 2009 and December 31, 2008, we held 100% of the Class B equity interests and 94.9% of the Class C equity interests.

<sup>(2)</sup> In addition to our investment in Ciena included in the portfolio, we have amounts receivable from or related to Ciena that are included in other assets in the accompanying consolidated financial statements. See below.

During the six months ended June 30, 2009, we funded \$51.4 million to support Ciena's term securitizations in lieu of draws under related standby letters of credit. This was required primarily as a result of the issuer of the letters of credit not extending maturing standby letters of credit due to events of default under our Revolving Line of Credit. The amounts funded were recorded as other assets in the accompanying consolidated balance sheet. At June 30, 2009 and December 31, 2008, other assets included amounts receivable from or related to Ciena totaling \$66.8 million and \$15.4 million at cost, respectively, and \$2.0 million and \$2.1 million at value, respectively. Net change in unrealized appreciation or depreciation included a net decrease related to our investment in and receivables from Ciena of \$18.9 million and \$63.0 million for the three and six months ended June 30, 2009, respectively. Net change in unrealized appreciation or depreciation included a net decrease in our investment in Ciena of \$29.3 million and \$68.6 million for the three and six months ended June 30, 2008, respectively.

In addition, at June 30, 2009, we had standby letters of credit issued under our line of credit of \$46.0 million issued in connection with term securitization transactions completed by Ciena. Our asset coverage ratio currently is less than 200% and events of default have occurred and are continuing under our revolving line of credit. Therefore, we are precluded from borrowing under our line of credit to fund these standby letters of credit. We expect that the remaining standby letters of credit will not be extended by the issuer and we will need to fund with cash up to the full amount of



the remaining letters of credit on or prior to their maturity unless we are able to obtain replacement standby letters of credit. The remaining standby letters of credit mature by the end of October 2009. We have considered the letters of credit in the valuation of Ciena at June 30, 2009 and December 31, 2008.

Our investment in Ciena was on non-accrual status, therefore we did not earn any interest and related portfolio income from our investment in Ciena for each of the three and six months ended June 30, 2009 and 2008.

At June 30, 2009, Ciena had two non-recourse securitization warehouse facilities, both of which have matured. In order to pay down debt under the conventional loan warehouse facility, Ciena sold the loans on behalf of the conventional loan warehouse facility providers. Ciena is also working with the providers of the SBA loan warehouse facility with regard to the repayment of that facility. We have issued performance guaranties whereby we agreed to indemnify the warehouse providers for any damages, losses, liabilities and related costs and

expenses that they may incur as a result of Ciena's failure to perform any of its obligations as loan originator, loan seller or loan servicer under the warehouse securitizations.

The Office of the Inspector General of the SBA (OIG) and the United States Secret Service are conducting ongoing investigations of allegedly fraudulently obtained SBA guaranteed loans issued by Ciena. Ciena also is subject to other SBA and OIG audits, investigations, and reviews. In addition, the Office of the Inspector General of the U.S. Department of Agriculture is conducting an investigation of Ciena's lending practices under the Business and Industry Loan (B&I) program. The OIG and the U.S. Department of Justice are also conducting a civil investigation of Ciena's lending practices in various jurisdictions. We are unable to predict the outcome of these inquiries, and it is possible that third parties could try to seek to impose liability against us in connection with certain defaulted loans in Ciena's portfolio. These investigations, audits and reviews are ongoing.

These investigations, audits, reviews, and litigation have had and may continue to have a material adverse impact on Ciena and, as a result, could continue to negatively affect our financial results. We have considered Ciena's voluntary filing for bankruptcy protection, the letters of credit, current regulatory issues, ongoing investigations and litigation in performing the valuation of Ciena at June 30, 2009 and December 31, 2008.

### 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 six months ended June 30, 2009 and 2008, and at and for the year ended December 31, 2008, were as follows:

(\$ in millions)	At and for the Three Months Ended June 30,				At and for the Six Months Ended June 30,				At and for the Year Ended December 31,	
	2009		2008		2009		2008		2008	
	Value	Yield <sup>(1)</sup>	Value	Yield <sup>(1)</sup>	Value	Yield <sup>(1)</sup>	Value	Yield <sup>(1)</sup>	Value	Yield <sup>(1)</sup>
Portfolio at value:										
Commercial mortgage loans	\$ 53.0	6.5%	\$ 47.4	7.8%	\$ 53.0	6.5%	\$ 47.4	7.8%	\$ 53.5	7.4%
Real estate owned	6.6		27.2		6.6		27.2		20.8	
Equity interests	14.1		32.2		14.1		32.2		19.6	
Total portfolio	\$ 73.7		\$ 106.8		\$ 73.7		\$ 106.8		\$ 93.9	
Investments funded	\$ 0.8		\$ 1.7		\$ 1.8		\$ 2.2		\$ 10.1	
Payment-in-kind interest, net of cash collections	\$		\$		\$		\$ 0.2		\$ 0.2	
Principal collections related to investment repayments or sales	\$ 4.5		\$ 8.3		\$ 5.6		\$ 16.7		\$ 16.8	

<sup>(1)</sup> The weighted average yield on the interest-bearing investments 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 interest-bearing investments 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. Interest-bearing investments for the commercial real estate finance portfolio include all investments except for real estate owned and equity interests.

At June 30, 2009, we had outstanding funding commitments related to the commercial real estate portfolio of \$31.3 million, and commitments in the form of standby letters of credit and guarantees related to equity interests of \$6.9 million.

### **Managed Funds**

In addition to managing our own assets, we manage certain funds that also invest in the debt and equity securities of primarily private middle market companies in a variety of industries. At June 30, 2009, we had eight separate funds under our management (together, the Managed Funds) for which we may earn management or other fees for our services. We may invest in the equity of these funds, along with other third parties, from which we may earn a current return and/or a future incentive allocation.

On March 3, 2009, we announced the completion of the acquisition of the management contracts of three middle market senior debt CLOs (together, the Emporia Funds) and certain other related assets for approximately

\$11 million (subject to post-closing adjustments). The acquired assets are included in other assets in the accompanying consolidated balance sheet and will be amortized over the life of the contracts. The Emporia Funds primarily invest in middle market and broadly syndicated senior secured loans. We are not an investor in the Emporia Funds.

The assets of the Managed Funds at June 30, 2009 and December 31, 2008, and our management fees as of June 30, 2009 were as follows:

(\$ in millions) Name of Fund	Assets of Managed Funds		Management Fee <sup>(2)</sup>
	June 30, 2009	December 31, 2008	
Senior Secured Loan Fund LLC <sup>(3)</sup>	\$ 945.4	\$ 789.8	0.375%
Allied Capital Senior Debt Fund, L.P.	359.7	412.9	1.625% <sup>(1)(2)</sup>
Knightsbridge CLO 2007-1 Ltd.	503.0	500.6	0.600%
Knightsbridge CLO 2008-1 Ltd.	306.7	304.8	0.600%
Emporia Preferred Funding I, Ltd.	420.8		0.625% <sup>(1)</sup>
Emporia Preferred Funding II, Ltd.	354.0		0.650% <sup>(1)</sup>
Emporia Preferred Funding III, Ltd.	407.1		0.650% <sup>(1)</sup>
AGILE Fund I, LLC	85.2	99.3	(1)
Total Assets	\$ 3,381.9	\$ 2,107.4	

(1) In addition to the management fees, we are entitled to an incentive allocation subject to certain performance benchmarks. There can be no assurance that the incentive allocation will be earned.

(2) Management fees are stated as a percent of assets except for the Allied Capital Senior Debt Fund, L.P. ( ACSDF ) which is stated as a percent of equity capital. The management fee paid by ACSDF was 2.000% at December 31, 2008 and was reduced to 1.625% effective January 1, 2009 for the 2009 calendar year.

(3) In June 2009, the Unitranche Fund LLC was renamed the Senior Secured Loan Fund LLC.

A portion of the management fees earned by us may be deferred under certain circumstances. Collection of the fees earned is dependent in part on the performance of the fund. We may pay a portion of management fees we receive to Callidus Capital Corporation, a portfolio investment controlled by us, for services provided as special manager to the Allied Capital Senior Debt Fund, L.P., Knightsbridge CLO 2007-1 Ltd., Knightsbridge CLO 2008-1 Ltd. and the Emporia Funds.

Our responsibilities to the Managed Funds may include investment origination, underwriting, and portfolio monitoring services. Each of the Managed Funds may separately invest in the debt or equity of companies in our portfolio, and these investments may be senior, pari passu or junior to the debt and equity investments held by us. We may or may not participate in investments made by the Managed Funds. We intend to grow our managed capital base over time. By growing our privately managed capital base, we seek to diversify our sources of capital, leverage our core investment expertise and increase fees and other income from asset management activities.

During the six months ended June 30, 2009, we sold assets to certain of the Managed Funds for which we received proceeds of \$9.7 million and we recognized a net realized gain of \$6.3 million. During the three and six months ended June 30, 2008, we sold assets to certain of the Managed Funds, for which we received proceeds of \$274.9 million and

\$303.9 million, respectively, and we recognized realized gains of \$5.3 million and \$4.2 million, respectively.

In addition to managing these funds, we hold certain investments in the Managed Funds as follows:

(\$ in millions) Name of Fund	Investment Description	June 30, 2009		December 31, 2008	
		Cost	Value	Cost	Value
Senior Secured Loan Fund LLC <sup>(1)</sup>	Subordinated Certificates and Equity Interests	\$ 166.3	\$ 154.2	\$ 125.4	\$ 125.4
Allied Capital Senior Debt Fund, L.P.	Equity interests	31.8	33.1	31.8	31.8
Knightsbridge CLO 2007-1 Ltd.	Class E Notes and Income Notes	58.3	37.2	59.6	50.1
Knightsbridge CLO 2008-1 Ltd.	Class C Notes, Class D Notes, Class E Notes and Income Notes	52.9	46.3	52.7	52.7
AGILE Fund I, LLC	Equity Interests	0.7	0.4	0.7	0.5
Total		\$ 310.0	\$ 271.2	\$ 270.2	\$ 260.5

(1) We have committed up to a total of \$525.0 million of subordinated certificates to the Senior Secured Loan Fund. The Senior Secured Loan Fund will be capitalized as investment transactions are completed. Investments made by the Senior Secured Loan Fund must be approved by the investment committee of the Senior Secured Loan Fund, which includes a representative from us. Therefore, our commitment to the Senior Secured Loan Fund cannot be drawn without our approval.

## PORTFOLIO ASSET QUALITY

**Loans and Debt Securities on Non-Accrual Status.** 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.

At June 30, 2009, and December 31, 2008, loans and debt securities at value not accruing interest for the total investment portfolio were as follows:

(\$ in millions)	2009	2008
Private finance		
Companies more than 25% owned	\$ 155.0	\$176.1
Companies 5% to 25% owned	14.4	
Companies less than 5% owned	74.8	151.8
Commercial real estate finance	9.8	7.7
Total	\$ 254.0	\$335.6
Percentage of total portfolio	10.0%	9.6%

At June 30, 2009 and December 31, 2008, private finance non-accruals included our senior secured debt in Ciena, which was \$93.0 million or 3.6% and \$104.9 million or 3.0%, respectively, of the total portfolio at value. The Ciena senior secured loan was acquired in the third quarter of 2008 and was placed on nonaccrual status upon its purchase. See Private Finance Ciena Capital LLC above. During the six months ended June 30, 2009, we placed certain interest bearing investments in 8 portfolio companies on non-accrual; however, non-accruals decreased primarily due to unrealized depreciation. The increase in loans and debt securities not accruing interest as a percentage of the total portfolio as of June 30, 2009 as compared to December 31, 2008, is a result of the overall decrease in the size of the portfolio.

**Loans and Debt Securities Over 90 Days Delinquent.** Loans and debt securities greater than 90 days delinquent at value at June 30, 2009, and December 31, 2008, were as follows:

(\$ in millions)	2009	2008
Private finance	\$ 95.4	\$106.6
Commercial mortgage loans	1.3	1.4
Total	\$ 96.7	\$108.0
Percentage of total portfolio	3.8%	3.1%

At June 30, 2009 and December 31, 2008, private finance loans and debt securities over 90 days delinquent included our senior secured debt in Ciena, which was \$93.0 million or 3.6% and \$104.9 million or 3.0%, respectively, of the total portfolio at value. The Ciena senior secured loan was acquired in the third quarter of 2008 and was placed on nonaccrual status upon its purchase. See Private Finance Ciena Capital LLC above.

The amount of the portfolio that is on non-accrual status or greater than 90 days delinquent may vary from period to period primarily resulting from changes in the composition of the portfolio as a result of new investment, repayment, and exit activity, and changes in investment values. The private equity business is, in part, about working with troubled portfolio companies to improve their businesses and protect our investment. We continue to follow our historical practice of working with portfolio companies in order to realize the potential of each investment. 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 \$96.7 million and \$108.0 million at June 30, 2009, and December 31, 2008, respectively. Our assets on non-accrual are higher than our loans over 90 days delinquent primarily due to the effect of loans with payment-in-kind interest. Loans with payment-in-kind interest experience no payment delinquency, but collection of that payment-in-kind interest in the future may be doubtful and we may determine that the loan should be placed on non-accrual. Given the severity of this economic recession, we would expect that non-accruals and loans over 90 days delinquent may increase in the future.



**RESULTS OF OPERATIONS****Comparison of the Three and Six Months Ended June 30, 2009 and 2008**

The following table summarizes our operating results for the three and six months ended June 30, 2009 and 2008.

except per share amounts)	For the Three Months Ended June 30,				For the Six Months Ended June		
	2009 (unaudited)	2008	Change	Percent Change	2009 (unaudited)	2008	Change
<b>Related Portfolio Income</b>							
Dividends	\$ 75,657	\$ 119,212	\$ (43,555)	(36.5)%	\$ 164,387	\$ 253,872	\$ (89,485)
Other income	8,973	15,366	(6,393)	(41.6)%	15,425	25,650	(10,225)
and related portfolio income	84,630	134,578	(49,948)	(37.1)%	179,812	279,522	(99,710)
	43,117	36,465	6,652	18.2%	86,602	74,025	12,577
	10,964	13,344	(2,380)	(17.8)%	22,034	35,996	(13,962)
Warrant options	1,204	3,859	(2,655)	(68.8)%	1,977	8,054	(6,077)
	8,459	12,943	(4,484)	(34.6)%	18,304	21,962	(3,658)
Long-lived asset				*	2,873		2,873
Operating expenses	63,744	66,611	(2,867)	(4.3)%	131,790	140,037	(8,247)
Income before income taxes	20,886	67,967	(47,081)	(69.3)%	48,022	139,485	(91,463)
Expense (benefit), including	2,653	4,112	(1,459)	(35.5)%	2,275	6,081	(3,806)
Income	18,233	63,855	(45,622)	(71.4)%	45,747	133,404	(87,657)
<b>and Unrealized Gains</b>							
Gains (losses)	(126,056)	(17,855)	(108,201)	*	(153,165)	(14,712)	(138,453)
Unrealized appreciation or	(2,777)	(148,203)	145,426	*	(352,847)	(261,607)	(91,240)
(losses)	(128,833)	(166,058)	37,225	*	(506,012)	(276,319)	(229,693)
Repayment of debt	81,537		81,537	*	83,532		83,532
Loss	\$ (29,063)	\$ (102,203)	\$ 73,140	71.6%	\$ (376,733)	\$ (142,915)	\$ (233,818)
Earnings (loss) per common share	\$ (0.16)	\$ (0.59)	\$ 0.43	72.9%	\$ (2.11)	\$ (0.85)	\$ (1.26)
Weighted average common shares							
Diluted	178,695	172,968	5,727	3.3%	178,694	167,238	11,456

\* Comparisons may not be meaningful. Net change in unrealized appreciation or depreciation and net gains (losses) can fluctuate significantly from period to period.

**Interest and Related Portfolio Income.** Interest and related portfolio income includes interest and dividend income and fees and other income.

**Interest and Dividends.** Interest and dividend income for the three and six months ended June 30, 2009 and 2008, was composed of the following:

(\$ in millions)	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2009	2008	2009	2008
Interest				
Private finance loans and debt securities	\$ 65.0	\$ 108.0	\$ 143.1	\$ 215.0
Preferred shares/income notes of CLOs	2.1	7.9	4.3	15.5
Subordinated certificates in Senior Secured Loan Fund LLC	3.0	1.4	5.9	1.6
Commercial mortgage loans	0.9	1.0	1.8	2.2
Cash, U.S. Treasury bills, money market and other securities	0.4	0.7	0.4	2.5
Total interest	71.4	119.0	155.5	236.8
Dividends	4.3	0.2	8.9	17.1
Total interest and dividends	\$ 75.7	\$ 119.2	\$ 164.4	\$ 253.9

The level of 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 June 30, 2009 and 2008, were as follows:

(\$ in millions)	2009		2008	
	Value	Yield <sup>(1)</sup>	Value	Yield <sup>(1)</sup>
Private finance:				
Loans and debt securities:				
Senior loans	\$ 287.1	4.9%	\$ 330.9	6.4%
Unitranche debt	376.7	12.2%	627.6	12.2%
Subordinated debt	1,186.6	13.8%	2,292.0	13.7%
Equity securities:				
Preferred shares/income notes of CLOs	82.1	11.1%	232.6	16.0%
Subordinated certificates in Senior Secured Loan Fund LLC	154.2	10.0%	94.6	10.2%
Commercial real estate:				
Commercial mortgage loans	53.0	6.5%	47.4	7.8%
Total interest-bearing investments	\$ 2,139.7	11.8%	\$ 3,625.1	12.7%

(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 interest-bearing investments at value. The weighted average yield on the preferred shares/income notes of CLOs is calculated as the (a) effective interest yield on the preferred shares/income notes of CLOs, divided by (b) preferred shares/income notes of CLOs at value. The weighted average yield on the subordinated certificates in the Senior Secured Loan Fund LLC is computed as the (a) annual stated interest rate divided by (b) total investment at value. This yield excludes any return from the potential future excess cash flows from portfolio earnings available to the subordinated certificate holders and from related structuring fees and management and sourcing fees. See Fees and Other Income below. The weighted average yields are computed as of the balance sheet date.

Interest income has decreased over the 2008 periods primarily as a result of decreases in the weighted average yield and decreases in the aggregate size of the interest-bearing portfolio due to disposition of certain investments as we have been harvesting capital from our portfolio in order to generate capital to repay our indebtedness and de-lever our balance sheet. The amount of subordinated debt in our portfolio, which carries a higher yield than other categories of loans and

debt securities, has decreased from \$2.3 billion at June 30, 2008 to \$1.2 billion at June 30, 2009. Interest income also decreased by approximately \$3.8 million due to additional investments being placed on non-accrual status during the six months ended June 30, 2009. The weighted average yield varies from period to period based on the current stated interest on interest-bearing investments, the yield on interest-bearing investments funded, the yield on amounts repaid, the amount of interest-bearing investments for which interest is not accruing, changes in value of interest-bearing investments and the mix of interest-bearing investments in the portfolio, including the amount of lower-yielding senior or unitranche debt in the portfolio at the end of the period. Because we recently have exited, and in the future intend to exit, several interest-bearing investments in order to accumulate capital for repayment of debt, we expect that income from our interest-bearing investments will continue to decrease in 2009.

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 for the six months ended June 30, 2009, was \$8.9 million as compared to \$17.1 million for the six months ended June 30, 2008. Dividend income for the six months ended June 30, 2008 includes a \$7.1 million dividend received in connection with the recapitalization of Norwesco, Inc., and \$5.4 million of dividends received in connection with the sale to AGILE Fund I, LLC. 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.

*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 six months ended June 30, 2009 and 2008, included fees relating to the following:

(\$ in millions)	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2009	2008	2009	2008
Fund management fees <sup>(1)</sup>	\$ 4.3	\$ 1.6	\$ 7.1	\$ 2.2
Management, consulting and other services provided to portfolio companies	1.9	3.1	4.1	6.0
Structuring and diligence	1.5	8.4	1.5	13.5
Commitment, guaranty and other fees from portfolio companies	1.2	1.9	1.8	3.6
Loan prepayment premiums	0.1	0.3	0.9	0.3
Other income		0.1		0.1
Total fees and other income	\$ 9.0	\$ 15.4	\$ 15.4	\$ 25.7

(1) See Portfolio and Investment Activity Managed Funds above.

Fees and other income generally are 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 and the level of assets in managed funds for which we earn management or other fees. We have added several new Managed Funds

since June 30, 2008, which resulted in an increase in fund management fees. Given our outlook for future investment activity for our balance sheet as well as for certain Managed Funds, we expect that total fee income in the future will reflect lower new investment levels. 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 included fees earned by us in connection with investments made by the Senior Secured Loan Fund LLC of \$1.4 million and \$5.4 million for the three months ended June 30, 2009 and 2008, respectively, and \$1.5 million and \$7.2 million, for the six months ended June 30, 2009 and 2008, respectively. See

Managed Funds above. The remainder of the structuring and diligence fees for 2008 primarily related to the level of new investment originations. Because we expect new investment activity to continue to be at a low level, we expect structuring and diligence fees to be lower in 2009 than in 2008.

**Operating Expenses.** Operating expenses include interest, employee, employee stock options, administrative expenses and the impairment of long-lived asset.

**Interest Expense.** The fluctuations in interest expense during the three and six months ended June 30, 2009 and 2008, primarily were attributable to increases in our weighted average cost of debt capital as well as changes in the level of our borrowings under various notes payable 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 six months ended June 30, 2009 and 2008, were as follows:

(\$ in millions)	At and for the Three Months Ended June 30,		At and for the Six Months Ended June 30,	
	2009	2008	2009	2008
Total outstanding debt	\$ 1,810.5	\$ 2,043.3	\$ 1,810.5	\$ 2,043.3
Average outstanding debt	\$ 1,862.8	\$ 2,042.9	\$ 1,903.6	\$ 2,126.2
Weighted average cost <sup>(1)</sup>	8.6%	6.9%	8.6%	6.9%

<sup>(1)</sup> 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. Events of default have occurred and are continuing under the Revolving Line of Credit and Private Notes which have increased the interest rates by 2.00% in 2009 during the continuance of such events of default.

On December 30, 2008, we amended our private notes and revolving line of credit, which increased the stated interest rate on those obligations by 100 basis points. Subsequent to this amendment, events of default have occurred and are continuing on these instruments. Pursuant to the terms of the revolving credit facility, during the continuance of an event of default, the applicable spread on any borrowings outstanding and fees on any letters of credit outstanding under the revolving credit facility increase by up to an additional 200 basis points. Pursuant to the private notes, during the continuance of an event of default, the rate of interest borne by the private notes increases by an additional 200 basis points. During the three and six months ended June 30, 2009, we incurred additional interest expense totaling \$5.3 million and \$8.8 million, respectively, related to the default interest. In July 2009, we agreed in principle to terms with our lenders on a comprehensive restructuring of these debt agreements. The terms of the restructuring are non-binding and remain subject to final documentation and closure. We expect that any restructuring will significantly increase our cost of capital. See Financial Condition, Liquidity and Capital Resources below.

In addition, interest expense included interest paid to the Internal Revenue Service related to installment sale gains totaling \$1.5 million and \$2.0 million for the three months ended June 30, 2009 and 2008, respectively, and \$3.4 million and \$3.8 million for the six months ended June 30, 2009 and 2008, respectively. Installment interest expense for the year ended December 31, 2009, is estimated to be approximately \$7.8 million. See Dividends and Distributions below.

*Employee Expense.* Employee expenses for the three and six months ended June 30, 2009 and 2008, were as follows:

(\$ in millions)	For the Three Months Ended		For the Six Months Ended	
	June 30,		June 30,	
	2009	2008	2009	2008
Salaries and employee benefits	\$ 8.7	\$ 12.3	\$ 17.5	\$ 24.7
Bonuses and performance awards <sup>(2)</sup>	2.3	(3.8)	4.5	6.5
Individual performance award (IPA)		2.2		4.6
IPA mark to market expense (benefit)				(4.1)
Individual performance bonus (IPB)		2.6		4.3
Total employee expense <sup>(1)</sup>	\$ 11.0	\$ 13.3	\$ 22.0	\$ 36.0
Number of employees at end of period	133	183	133	183

<sup>(1)</sup> Excludes employee stock options expense. See below.

<sup>(2)</sup> Amounts for the three and six months ended June 30, 2008, include the reversal of previously accrued bonuses.

During the second half of 2008, we consolidated our investment execution activities to our Washington, DC headquarters and our office in New York in an effort to improve our operating efficiencies and reduced our headcount by approximately 50 employees. Our employee expense for the first two quarters of 2009 reflects this reduction in headcount and we continue to identify ways to reduce employee expense.

The quarterly accrual for employee bonuses 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. Employee bonuses generally are paid after the completion of the fiscal year.

The IPA and IPB were part of an incentive compensation program for certain officers and generally were determined annually at the beginning of each year but could be adjusted throughout the year. In 2008, the IPA was paid in cash in two equal installments during the year. Through December 31, 2007, the IPA amounts were contributed into a trust and invested in our common stock. The IPB was distributed in cash to award recipients throughout the year (beginning in February of each respective year) as long as the recipient remained employed by us. We currently have not established an IPA or IPB for 2009; however, depending upon our need to retain and motivate our employees, we may determine in conjunction with the Compensation Committee of the Board of Directors that some form of 2009 retention compensation or individual performance compensation may be in the best interests of the company.

The trusts for the IPA payments were consolidated with our accounts. The common stock was classified as common stock held in deferred compensation trust in the accompanying financial statements and the deferred compensation obligation, which represented the amount owed to the employees, was included in other liabilities. Changes in the value of our common stock held in the deferred compensation trust were not recognized. However, the liability was marked to market with a corresponding charge or credit to employee compensation expense. On December 14, 2007, our Board of Directors made a determination that it was in Allied Capital's best interest to terminate our deferred compensation arrangements. The Board of Directors' decision primarily was in response to increased complexity resulting from changes in the regulation of deferred compensation arrangements. The Board of Directors resolved that



the accounts under these Plans would be distributed to participants in full on March 18, 2008, the termination and distribution date, or as soon as was reasonably practicable thereafter, in accordance with the provisions of each of these Plans.

The accounts under the deferred compensation arrangements totaled \$52.5 million at December 31, 2007. The balances on the termination date were distributed to participants in March 2008 subsequent to the termination date, in accordance with the transition rule for payment elections under Section 409A of the Code. Distributions from the plans were made in cash or shares of our common stock, net of required withholding taxes. The distribution of the

accounts under the deferred compensation arrangements resulted in a tax deduction for 2008, subject to the limitations set by Section 162(m) of the Code for persons subject to such section.

*Employee Stock Options Expense.* The employee stock options expense for the three and six months ended June 30, 2009 and 2008, was as follows:

(\$ in millions)	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2009	2008	2009	2008
Employee Stock Option Expense:				
Previously awarded, unvested options as of January 1, 2006	\$	\$ 2.1	\$	\$ 3.9
Options granted on or after January 1, 2006	1.2	1.8	2.0	4.2
Total employee stock option expense	\$ 1.2	\$ 3.9	\$ 2.0	\$ 8.1

On March 3, 2009, the Compensation Committee of our Board of Directors granted 10.6 million options with an exercise price of \$0.73 per share. The options vest in three equal installments on June 30, 2009, June 30, 2010 and June 30, 2011. On May 13, 2009, the Compensation Committee of our Board of Directors granted 0.9 million options with an exercise price of \$2.63 per share. A total of 55,000 options vested immediately and the remaining options vest as follows: 166,667 on June 30, 2009, 333,333 on April 30, 2010, 180,000 on June 30, 2010 and 180,000 on June 30, 2011.

We estimate that the employee-related stock options expense will be approximately \$4.4 million, \$4.4 million, and \$3.7 million for the years ended December 31, 2009, 2010, and 2011, respectively. This estimate does not include any expense related to stock option grants after June 30, 2009, as the fair value of those stock options will be determined at the time of grant. This estimate may change if our assumptions related to future option forfeitures change.

*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 option expense, and various other expenses.

Administrative expenses were \$8.5 million and \$12.9 million, for the three months ended June 30, 2009 and 2008, respectively, and \$18.3 million and \$22.0 million for the six months ended June 30, 2009 and 2008, respectively. Administrative expenses decreased primarily due to a decrease in travel costs and other professional fees. We intend to continue to identify ways to reduce administrative expense.

*Impairment of Long-Lived Asset.* In our efforts to reduce overall administrative expenses, we sold our corporate aircraft during 2009. The sales price of the aircraft was less than our carrying cost, therefore, we recorded an impairment charge of \$2.9 million during the quarter ended March 31, 2009.

*Gain on Repurchase of Debt.* During the six months ended June 30, 2009, we purchased publicly issued notes in the market with a total par value of \$134.5 million, which consisted of \$80.1 million of our 6.625% Notes due 2011 and \$54.4 million of our 6.000% Notes due 2012, for a total cost of \$50.3 million. After recognizing the remaining unamortized original issue discount associated with the notes repurchased, we recognized a net gain on repurchase of debt of \$81.5 million and \$83.5 million for the three and six months ended June 30, 2009, respectively.



**Income Tax Expense (Benefit), Including Excise Tax.** Income tax expense (benefit) for the three and six months ended June 30, 2009 and 2008, was as follows:

(\$ in millions)	For the Three Months Ended		For the Six Months Ended	
	June 30,		June 30,	
	2009	2008	2009	2008
Income tax expense (benefit)	\$ 2.7	\$ 2.2	\$ 2.3	\$ 1.9
Excise tax expense <sup>(1)</sup>		1.9		4.2
Income tax expense (benefit), including excise tax	\$ 2.7	\$ 4.1	\$ 2.3	\$ 6.1

<sup>(1)</sup> 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 (losses).

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.

We did not record an excise tax for the three and six months ended June 30, 2009. See Dividends and Distributions below.

**Realized Gains and Losses.** Net realized gains or losses primarily result from the sale of portfolio investments. Net realized gains (losses) for the three and six months ended June 30, 2009 and 2008, were as follows:

(\$ in millions)	For the Three Months Ended		For the Six Months Ended June 30,	
	June 30,		2009	
	2009	2008	2009	2008
Realized gains	\$ 8.6	\$ 5.0	\$ 21.3	\$ 37.7
Realized losses	(134.7)	(22.9)	(174.5)	(52.4)
Net realized gains (losses)	\$ (126.1)	\$ (17.9)	\$ (153.2)	\$ (14.7)

When we exit an investment and realize a gain or loss, we make an accounting entry to reverse any unrealized appreciation or depreciation, respectively, that we had previously recorded to reflect the appreciated or depreciated value of the investment. For the three and six months ended June 30, 2009 and 2008, we reversed previously recorded unrealized appreciation or depreciation when gains or losses were realized or dividends were received as follows:

For the Three Months Ended	For the Six Months Ended
-------------------------------	-----------------------------

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(\$ in millions)	June 30,		June 30,	
	2009	2008	2009	2008
Reversal of previously recorded net unrealized appreciation associated with realized gains	\$ (10.9)	\$ (2.2)	\$ (11.9)	\$ (34.7)
Reversal of previously recorded net unrealized appreciation associated with dividends received	(7.0)		(10.4)	(13.5)
Reversal of previously recorded net unrealized depreciation associated with realized losses	116.3	16.9	133.3	45.4
Total reversal	\$ 98.4	\$ 14.7	\$ 111.0	\$ (2.8)

Realized gains for the three months ended June 30, 2009 and 2008, were as follows:

(\$ in millions)

	<b>2009</b>	<b>Amount</b>
<b>Portfolio Company</b>		
<b>Private Finance:</b>		
Advantage Sales & Marketing, Inc.	\$	6.9
Other		1.6
Total private finance		8.5
<b>Commercial Real Estate:</b>		
Other		0.1
Total commercial real estate		0.1
Total realized gains	\$	8.6

	<b>2008</b>	<b>Amount</b>
<b>Portfolio Company</b>		
<b>Private Finance:</b>		
Mercury Air Centers, Inc.		\$2.6
MedAssets, Inc.		1.3
Havco Wood Products LLC		0.7
Other		0.3
Total private finance		4.9
<b>Commercial Real Estate:</b>		
Other		0.1
Total commercial real estate		0.1
Total realized gains		\$5.0

Realized losses for the three months ended June 30, 2009 and 2008, were as follows:

(\$ in millions)

2009

<b>Portfolio Company</b>	<b>Amount</b>
<b>Private Finance:</b>	
MHF Logistical Solutions, Inc.	\$ 70.7
Triax Holdings, LLC	21.9
FCP-BHI Holdings, LLC	8.2
Augusta Sportswear Group, Inc	6.2
The Hillman Companies, Inc.	5.7
Abraxas Corporation	3.5
Tank Intermediate Holding Corp.	2.0
Penn Detroit Diesel Allison, LLC	1.7
Huddle House, Inc.	1.3
Summit Energy Services, Inc.	1.3
Other	4.3
Total private finance	126.8
<b>Commercial Real Estate:</b>	
Real Estate Owned	7.9
Total commercial real estate	7.9
Total realized losses	\$ 134.7

## 2008

<b>Portfolio Company</b>	<b>Amount</b>
<b>Private Finance:</b>	
Creative Group, Inc.	\$15.5
Walker Investment Fund II, LLLP	1.3
Other	4.0
Total private finance	20.8
<b>Commercial Real Estate:</b>	
Other	2.1
Total commercial real estate	2.1
Total realized losses	\$22.9

Realized gains for the six months ended June 30, 2009 and 2008 were as follows:

(\$ in million)

<b>Portfolio Company</b>	<b>2009</b>	<b>Amount</b>
<b>Private Finance:</b>		
Advantage Sales & Marketing, Inc.	\$	6.9
GC-Sun Holdings, LP		6.8
Other		3.4
Total private finance		17.1
<b>Commercial Real Estate:</b>		
Real Estate Owned		4.1
Other		0.1
Total commercial real estate		4.2
Total realized gains	\$	21.3

<b>Portfolio Company</b>	<b>2008</b>	<b>Amount</b>
<b>Private Finance:</b>		
Norwesco, Inc.	\$	10.7
BenefitMall, Inc.		4.9
Advantage Sales & Marketing, Inc. <sup>(1)</sup>		3.4
Financial Pacific Company		3.1
Mercury Air Centers, Inc.		2.6
Service Champ, Inc.		1.7
Penn Detroit Diesel Allison, LLC		1.4
Coverall North America, Inc.		1.4
MedAssets, Inc.		1.3
CR Holding, Inc.		1.0
Other		5.9
Total private finance		37.4
<b>Commercial Real Estate:</b>		
Other		0.3
Total commercial real estate		0.3
Total realized gains	\$	37.7



<sup>(1)</sup> Includes an additional realized gain of \$1.9 million related to the release of escrowed funds from the sale of our majority equity investment in 2006.

Realized losses for the six months ended June 30, 2009 and 2008, were as follows:

(\$ in millions)

	<b>2009</b>	<b>Amount</b>
<b>Portfolio Company</b>		
<b>Private Finance:</b>		
MHF Logistical Solutions, Inc.	\$	70.7
Advantage Sales & Marketing, Inc.		27.3
Triax Holdings, LLC		21.9
FCP-BHI Holdings, LLC		8.2
Augusta Sportswear Group, Inc.		6.2
The Hillman Companies, Inc.		5.7
Old Orchard Brands, LLC		4.5
Tank Intermediate Holding Corp.		4.2
Abraxas Corporation		3.5
Pro Mach, Inc.		2.9
Becker Underwood, Inc.		2.8
Penn Detroit Diesel Allison, LLC		1.7
Huddle House, Inc.		1.3
Summit Energy Services, Inc.		1.3
Other		4.4
Total private finance		166.6
<b>Commercial Real Estate:</b>		
Real Estate Owned		7.9
Other		0.0
Total commercial real estate		7.9
Total realized losses	\$	174.5
	<b>2008</b>	
<b>Portfolio Company</b>		<b>Amount</b>
<b>Private Finance:</b>		
Creative Group, Inc.	\$	15.5
Crescent Equity Corp. Longview Cable & Data, LLC		8.4
Mid-Atlantic Venture Fund IV, L.P.		5.2
WMA Equity Corporation and Affiliates		4.5
Driven Brands, Inc.		1.9
Direct Capital Corporation		1.7
EarthColor, Inc.		1.7
Sweet Traditions, Inc.		1.5
Walker Investment Fund II, LLLP.		1.3
Other		8.2
		178

Total private finance		49.9
<b>Commercial Real Estate:</b>		
Other		2.5
Total commercial real estate		2.5
Total realized losses	\$	52.4

During the six months ended June 30, 2009, we focused our efforts on harvesting capital from our portfolio in order to generate capital to repay indebtedness and de-lever our balance sheet. These asset sales have been completed under distressed conditions in a very difficult market and consequently we have realized net losses upon their disposition. For the six months ended June 30, 2009, we sold or had repayments on portfolio investments that generated cash proceeds of \$587.3 million.

Realized gains and losses for the six months ended June 30, 2009 and 2008, include net realized gains of \$6.3 million and \$5.4 million, respectively (subsequent to post-closing adjustments), from the sales of certain investments to our Managed Funds. See [Managed Funds](#) above.

***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 in accordance with our valuation policy and the provisions of the 1940 Act and FASB Statement No. 157, *Fair Value Measurements* (SFAS 157 or the Statement) and related interpretations. We determine fair value to be the price that would be received for an investment in a current sale, which assumes an orderly transaction between market participants on the measurement date. At June 30, 2009, portfolio investments recorded at fair value using level 3 inputs (as defined under the Statement) were approximately 79% of our total assets. Because of the inherent uncertainty of determining the fair value of investments that do not have a readily available market quotation in an active market, 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 approach 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 determine that the fair value of a security is less than its cost basis, and we will record unrealized appreciation when we determine that the fair value is greater than its cost basis. 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 invest in illiquid securities including debt and equity securities of portfolio companies, CLO bonds and preferred shares/income notes, CDO bonds and investment funds. 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.* We adopted SFAS 157 on a prospective basis in the first quarter of 2008. SFAS 157 requires us to assume that the portfolio investment is to be sold in the principal market to market participants, or in the absence of a principal market, the most advantageous market, which may be a hypothetical market. Market participants are defined as buyers and sellers in the principal or most advantageous market that are independent, knowledgeable, and willing and able to transact. In accordance with the Statement, we have considered our principal market, or the market in which we exit our portfolio investments with the greatest volume and level of activity.

We have determined that for our buyout investments, where we have control or could gain control through an option or warrant security, both the debt and equity securities of the portfolio investment would exit in the merger and acquisition (M&A) market as the principal market generally through a sale or recapitalization of the portfolio company. We believe that the in-use premise of value (as defined in SFAS 157), which assumes the debt and equity securities are sold together, is appropriate as this would provide maximum proceeds to the seller. As a result, we use the enterprise value methodology to determine the fair value of these investments under SFAS 157. Enterprise value means the entire value of the company to a market participant, including the sum of the values of debt and equity securities used to capitalize the enterprise at a point in time. Enterprise value is determined using various factors, including cash flow from operations of the portfolio company, multiples at which private companies are bought and sold, 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. We allocate the enterprise value to these securities in order of the legal priority of the securities.

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. However, we must derive a single estimate of enterprise value. To determine the enterprise value of a portfolio company, we analyze its historical and projected financial results. This financial and other information is generally obtained from the portfolio companies, and may represent unaudited, projected or pro forma financial information. 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, the entry multiple for the transaction, 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.

While we typically exit our securities upon the sale or recapitalization of the portfolio company in the M&A market, for investments in portfolio companies where we do not have control or the ability to gain control through an option or warrant security, we cannot typically control the exit of our investment into the principal market (the M&A market). As a result, in accordance with SFAS 157, we are required to determine the fair value of these investments assuming a sale of the individual investment (the in-exchange premise of value) in a hypothetical market to a hypothetical market participant. We continue to perform an enterprise value analysis for the investments in this category to assess the credit risk of the loan or debt security and to determine the fair value of our equity investment in these portfolio companies. The determined equity values are generally discounted when we have a minority ownership position, restrictions on resale, specific concerns about the receptivity of the capital markets to a specific company at a certain time, or other factors. For loan and debt securities, we perform a yield analysis assuming a hypothetical current sale of the investment. The yield analysis requires us to estimate the expected repayment date of the instrument and a market participant's required yield. Our estimate of the expected repayment date of a loan or debt security may be shorter than the legal maturity of the instruments as our loans have historically been repaid prior to the maturity date. The yield analysis considers changes in interest rates and changes in leverage levels of the loan or debt security as compared to market interest rates and leverage levels. Assuming the credit quality of the loan or debt security remains stable, we will use the value determined by the yield analysis as the fair value for that security. A change in the assumptions that we use to estimate the fair value of our loans and debt securities using the yield analysis could have a material impact on the determination of fair value. If there is deterioration in credit quality or a loan or debt security is in workout status, we may consider other factors in determining the fair value of a loan or debt security, including the value attributable to the loan or debt security from the enterprise value of the portfolio company or the proceeds that would be received in a liquidation analysis.

Our equity investments in private debt and equity funds are generally valued based on the fund's net asset value, unless other factors lead to a determination of fair value at a different amount. The value of our equity securities in public companies for which quoted prices in an active market are readily available is based on the closing public market price on the measurement date.

The fair value of our CLO/CDO Assets is generally based on a discounted cash flow model that utilizes prepayment, re-investment, loss and ratings 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 CLO/CDO Assets as comparable yields in the market change and/or based on changes in estimated cash flows resulting from changes in prepayment, re-investment, loss or ratings assumptions in the underlying collateral pool or changes in redemption assumptions for the CLO/CDO Assets, if applicable. We determine the fair value of our CLO/CDO Assets on an individual security-by-security basis. If we were to sell a group of these CLO/CDO 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 assets.

We record unrealized depreciation on investments when we determine that the fair value of a security is less than its cost basis, and record unrealized appreciation when we determine that the fair value is greater than its cost basis. Because of the inherent uncertainty of valuation, the values determined at the measurement date 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. Additionally, changes in the market environment and other events that may occur over the life of the investments may cause the gains or losses ultimately realized on these investments to be different than the values determined at the measurement date. In accordance with FSP 157-4 (discussed below), we do not consider a transaction price that is associated with a transaction that is not orderly to be indicative of fair value or market participant risk premiums, and accordingly would place little, if any, weight on transactions that are not orderly in determining fair value. When considering recent potential or completed transactions, we use judgment in determining if such offers or transactions were pursuant to an orderly process for purposes of determining how much weight is placed on these data points in accordance with the applicable guidelines in SFAS 157 and FSP 157-4.

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 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 is submitted to our Board of Directors who is ultimately responsible for the determination of fair value of the portfolio in good faith. Valuation assistance from Duff & Phelps, LLC (Duff & Phelps) for our private finance portfolio consisted of certain limited procedures (the Procedures) we identified and requested them to perform. Based upon the performance of the Procedures on a selection of our final portfolio company valuations, Duff & Phelps concluded that the fair value of those portfolio companies subjected to the Procedures did not appear unreasonable. In addition, we also received third-party valuation assistance from other third-party consultants for certain private finance portfolio companies. For the three and six months ended June 30, 2009 and 2008, we received third-party valuation assistance as follows:

	2009		2008	
	Q1	Q2	Q1	Q2
Number of private finance portfolio companies reviewed	93	91	124	119
Percentage of private finance portfolio reviewed at value	94.0%	96.9%	94.0%	94.9%

Professional fees for third-party valuation assistance were \$1.9 million for the year ended December 31, 2008, and are estimated to be approximately \$1.3 million for 2009.



*Net Change in Unrealized Appreciation or Depreciation.* Net change in unrealized appreciation or depreciation for the three and six months ended June 30, 2009 and 2008, consisted of the following:

(\$ in millions)	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2009 <sup>(1)</sup>	2008 <sup>(1)</sup>	2009 <sup>(1)</sup>	2008 <sup>(1)</sup>
Net unrealized appreciation (depreciation)	\$ (101.2)	\$ (162.9)	\$ (463.8)	\$ (258.8)
Reversal of previously recorded unrealized appreciation associated with realized gains	(10.9)	(2.2)	(11.9)	(34.7)
Reversal of previously recorded net unrealized appreciation associated with dividends received	(7.0)		(10.4)	(13.5)
Reversal of previously recorded unrealized depreciation associated with realized losses	116.3	16.9	133.3	45.4
Net change in unrealized appreciation or depreciation	\$ (2.8)	\$ (148.2)	\$ (352.8)	\$ (261.6)

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

The primary drivers of the net unrealized depreciation of \$101.2 million resulting from changes in portfolio value for the quarter ended June 30, 2009, were (i) additional depreciation on our CLO/CDO investments, which totaled \$30.6 million (see Portfolio and Investment Activity, Private Finance), (ii) additional depreciation of \$23.8 million on our non-buyout debt investments as a result of using a yield analysis in accordance with the interpretations of SFAS 157, (iii) additional depreciation of \$18.9 million related to our investment in Ciena Capital (see Portfolio and Investment Activity, Private Finance above), and (iv) depreciation of \$12.1 million on our investment in the Senior Secured Loan Fund LLC as a result of increased market yields (see Portfolio and Investment Activity, Managed Funds above).

Other investments in the portfolio, in the aggregate, accounted for the remaining net unrealized depreciation in the second quarter of 2009. Enterprise value multiples for these companies averaged 6.5x with a median multiple of 6.1x for the second quarter valuations. This compares to enterprise value multiples for these companies used for first quarter 2009 valuations that averaged 6.4x with a median multiple of 6.2x.

**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 178.7 million and 173.0 million for the three months ended June 30, 2009 and 2008, respectively, and were 178.7 million and 167.2 million for the six months ended June 30, 2009 and 2008, respectively.

## OTHER MATTERS

**Regulated Investment Company Status.** We have elected to be taxed as a regulated investment company under Subchapter M of the Code. 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 Code; and (4) timely distribute

to shareholders at least 90% of our annual investment company taxable income (i.e., net ordinary investment income) as defined in the Code. With respect to taxable realized net long-term capital gains, we may choose to (i) distribute, (ii) deem to distribute, or (iii) retain and pay corporate level tax on such gains. We currently qualify as a regulated investment company. However, there can be no assurance that we will continue to qualify for such treatment in future years.

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 includes our taxable interest, dividend and fee income, as well as taxable net capital gains. 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 generally 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 generally 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. Taxable income includes non-cash income, such as payment-in-kind 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. Noncash taxable income is reduced by non-cash expenses, such as realized losses and depreciation and amortization expense.

Taxable income available for distribution includes investment company taxable income and, to the extent not deemed to be distributed or retained, net long-term capital gains. To the extent that annual taxable income available for distribution exceeds dividends paid or deemed distributed from such taxable income for the year, we may carry over the excess taxable income into the next year and such excess income will be available for distribution in the next year as permitted under the Code (see discussion below). Such excess income will be treated under the Code as having been distributed during the prior year for purposes of our qualification for RIC tax treatment for such year. The maximum amount of excess taxable income that we may carry over for distribution in the next year under the Code is the total amount of dividends paid in the following year, subject to certain declaration and payment guidelines. Excess taxable income carried over and paid out in the next year is generally subject to a nondeductible 4% excise tax.

## **DIVIDENDS AND DISTRIBUTIONS**

We have elected to be taxed as a regulated investment company under Subchapter M of the Code. As a regulated investment company, we are required to distribute substantially all of our investment company taxable income to shareholders through the payment of dividends. In certain circumstances, we are restricted in our ability to pay dividends. Each of our private notes and our revolving credit facility contain provisions that limit the amount of dividends we can pay and have a covenant that requires a minimum 200% asset coverage ratio at all times, and at June 30, 2009, we were in default of that covenant. During the continuance of an event of default, we are precluded from declaring dividends or other distributions to our shareholders. In addition, pursuant to the 1940 Act, we may be precluded from declaring dividends or other distributions to our shareholders unless our asset coverage is at least 200%.

We estimate that we have met our dividend distribution requirements for the 2008 tax year. We intend to retain capital in 2009 in order to comply with the 200% asset coverage requirements of the 1940 Act and our debt agreements and therefore, we currently do not expect to declare dividends in 2009. In July 2009, we agreed in principle to terms with the lenders under our revolving credit facility and the holders of our private notes on a comprehensive restructuring of these debt agreements. We expect the restructured debt to result in a significantly increased cost of capital. As a result, we expect our profitability will be substantially reduced and that we would not be able to pay a cash dividend for an extended period of time. We currently qualify as a regulated investment company. However there can be no assurance that we will be able to comply with the regulated investment company requirements to distribute income for the current and future years and we may be required to pay a corporate level income tax.

No dividends were paid or declared for the three and six months ended June 30, 2009. Dividends to common shareholders were \$0.65 per share each quarter for the first two quarters of 2008.



## FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

**Events of Default, Liquidity and Operations.** Beginning in the second half of 2008, we have experienced a significant reduction in our net worth, primarily resulting from net unrealized depreciation on our portfolio, which has reflected market conditions. As a result, on December 30, 2008, we entered into amendments relating to our private notes and revolving line of credit, including amendments which added new covenants. The amendments are more fully described in Note 4, Debt from our Notes to the Consolidated Financial Statements included in Item 1.

In January 2009 we re-opened discussions with the revolving line of credit lenders and the private noteholders to seek relief under certain terms of both the revolving credit facility and the private notes due to certain events of covenant default. At December 31, 2008, our asset coverage was less than the 200% required by the revolving credit facility and the private notes, and as of June 30, 2009, our asset coverage remained less than 200%. Asset coverage generally refers to the percentage resulting from assets less accounts payable and other liabilities, divided by total debt. In addition, we have not completed the documents contemplated by the December 30, 2008 amendments to the revolving credit facility and private notes, which were to include a grant of a first lien security interest on substantially all of our assets. Under the revolving credit facility and the private notes, events of default have occurred and are continuing related to these covenants and certain financial and other covenants.

The existence of an event of default under the revolving line of credit and private notes restricts us from additional borrowing or obtaining letters of credit under our revolving credit facility, and from declaring dividends or other distributions to our shareholders. Pursuant to the terms of the revolving credit facility, during the continuance of an event of default, the applicable spread on any borrowings outstanding and fees on any letters of credit outstanding under the revolving credit facility increase by up to 200 basis points. Pursuant to the terms of the private notes, during the continuance of an event of default, the rate of interest borne by the private notes increases by 200 basis points.

On March 27, 2009, pursuant to the terms of the revolving line of credit, the administrative agent for the lenders terminated substantially all of the unused commitments under the revolving line of credit. As a result, the aggregate commitments under our revolving line of credit were reduced to \$165.0 million. As of June 30, 2009, we had \$50.0 million in outstanding borrowings and \$62.0 million in outstanding letters of credit issued under the revolving line of credit. Subsequent to June 30, 2009, the aggregate commitments under the revolving line of credit were reduced to \$115.0 million.

Neither the lenders nor the noteholders have accelerated repayment of our obligations; however, the occurrence of an event of default permits the administrative agent for the lenders, or the holders of more than 51% of the commitments under the revolving credit facility, to accelerate repayment of all amounts due, to terminate commitments thereunder, and to require us to provide cash collateral equal to the face amount of all outstanding letters of credit. Pursuant to the terms of the private notes, the occurrence of an event of default permits the holders of 51% or more of any issue of outstanding private notes to accelerate repayment of all amounts due thereunder.

In July 2009, we agreed in principle to terms with the revolving line of credit lenders and the private noteholders on a comprehensive restructuring of these debt agreements. In connection with these restructuring discussions, we repaid \$100 million of the outstanding private notes in the third quarter of 2009. The terms of the restructuring are non-binding and remain subject to final documentation and closure. There can be no assurance of the timing of any debt restructuring or that we will complete a restructuring of our debt. Until the restructuring is completed, this debt remains subject to acceleration. We expect the restructured debt to result in a significantly increased cost of capital, including significant fees at closing. As a result, we expect our profitability will be substantially reduced and that we would not be able to pay a cash dividend for an extended period of time.

Pursuant to the 1940 Act, we are not permitted to issue indebtedness unless immediately after such issuance we have asset coverage of all outstanding indebtedness of at least 200%. Our publicly issued notes require us to comply with this provision of the 1940 Act. At June 30, 2009, our asset coverage ratio was 174%, which is less than the 200% requirement. As a result, under the publicly issued unsecured notes payable, we will not be able to issue additional

indebtedness until such time as our asset coverage returns to at least 200%. We have not experienced any default or cross default with respect to the publicly issued unsecured notes payable.

Our consolidated financial statements have been prepared assuming that we will continue as a going concern. We do not have available cash resources sufficient to satisfy all of the obligations under the revolving credit facility and the private notes, should the lenders accelerate these obligations. These factors raise substantial doubt about our ability to continue as a going concern. In addition, we continue to sell assets to generate capital to repay debt. There can be no assurance that our plans will be successful in addressing the liquidity uncertainties discussed above. In the event there is an acceleration of the amounts outstanding under the revolving credit facility or any issue of the private notes, it would cause us to evaluate other alternatives and would have a material adverse effect on our operations. The consolidated financial statements included in Item 1 herein do not include any adjustments that might result from these uncertainties.

During the six months ended June 30, 2009, we sold or had repayments on portfolio investments that generated \$587.3 million of cash proceeds. These asset sales have been completed under distressed conditions in a very difficult market and consequently we have realized net losses upon their disposition (see Realized Gains and Losses above). We expect to complete additional asset sales throughout the course of the year and given the challenging market and our desire to sell assets to generate liquidity, we may incur additional realized losses upon such dispositions. We expect that the cash generated from asset sales and repayments will be used to pay significant fees associated with the anticipated debt restructuring, repay indebtedness, and provide ongoing liquidity.

During the six months ended June 30, 2009, we paid \$30.1 million to repurchase certain of the 6.625% Notes due 2011 which had a face value of \$80.1 million, and \$20.2 million to repurchase certain of the 6.000% Notes due 2012 which had a face value of \$54.4 million. In the third quarter of 2009, we repaid \$100 million of our privately issued unsecured notes payable.

We may continue to engage in a variety of activities as a means to improve our asset coverage ratio and net asset value, which may include but are not limited to: continuing to sell assets to generate capital to retire debt; refinancing or repurchasing, at par or at a discount, our outstanding debt; and foregoing or limiting dividend payments in order to retain capital. We also plan to continue to carefully manage our employee and administrative expenses and may take additional steps to further reduce these expenses. There can be no assurance that we will be able to increase our asset coverage ratio or net asset value.

At June 30, 2009, and December 31, 2008, our 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)	2009	2008
Cash and investments in money market and other securities (including money market and other securities: 2009-\$415.0; 2008-\$0.3)	\$ 484.0	\$ 50.7
Total assets	\$ 3,209.1	\$ 3,722.2
Total debt outstanding	\$ 1,810.5	\$ 1,945.0
Total shareholders' equity	\$ 1,341.3	\$ 1,718.4
Debt to equity ratio	1.35	1.13
Asset coverage ratio <sup>(1)</sup>	174%	188%

(1)

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

Also pursuant to the 1940 Act, we may be precluded from declaring dividends or other distributions to our shareholders, or repurchasing shares of our common stock until such time as our asset coverage would be at least 200%. At June 30, 2009, our asset coverage ratio was 174% and, as a result, we currently are unable to declare dividends or other distributions to our shareholders, or repurchase shares of our common stock. In addition, we generally are not able to issue and sell our common stock at a price below net asset value per share. Our common stock currently is trading at a price below our net asset value of \$7.49 per share.



Cash generated from the portfolio includes cash flow from net investment income and net realized gains and principal collections related to investment repayments or sales. Cash flow provided by our operating activities before new investment activity for the six months ended June 30, 2009 and 2008, was as follows:

(\$ in millions)	2009	2008
Net cash provided by operating activities	\$ 68.4	\$ 197.3
Add: portfolio investments funded	98.7	594.0
Total cash provided by operating activities before new investments	\$ 167.1	\$ 791.3

Given the severe economic recession we are experiencing in the United States, we believe that our cash flows from investment exits for 2009 will be lower than prior years when we were in a more robust economy. We believe, however, that we will generate sufficient cash flow to fund our operations and meet our scheduled debt service requirements, although there can be no assurance that we will generate sufficient cash flow.

At June 30, 2009, and December 31, 2008, the value and yield of the cash and investments in money market and other securities were as follows:

(\$ in millions)	2009		2008	
	Value	Yield	Value	Yield
Money market and other securities	\$ 415.0		\$ 0.3	1.7%
Cash	69.0	0.1%	50.4	0.1%
Total	\$ 484.0	0.0%	\$ 50.7	0.1%

At June 30, 2009, we had \$484.0 million in cash and money market and other securities. During the third quarter of 2009, we repaid \$100 million of our privately issued unsecured notes payable. We intend to use a portion of our cash on hand to pay closing costs and to further reduce outstanding debt in connection with the debt restructuring discussed above.

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.

We evaluate our interest rate exposure on an ongoing basis. Generally, we seek to fund our primarily fixed-rate debt portfolio and our equity 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.

During the six months ended June 30, 2008, we sold new equity of \$402.5 million in public offerings. In addition, for the six months ended June 30, 2008 shareholders' equity increased through capital share transactions by \$4.0 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. Shareholders' equity also increased by \$26.4 million during

the six months ended June 30, 2008, as a result of the distribution of the common stock held in deferred compensation trusts.

At June 30, 2009, and December 31, 2008, we had outstanding debt as follows:

(\$ in millions)	2009			2008		
	Facility Amount	Amount Outstanding	Annual Interest Cost <sup>(1)</sup>	Facility Amount	Amount Outstanding	Annual Interest Cost <sup>(1)</sup>
Notes payable:						
Privately issued unsecured notes payable <sup>(5)</sup>	\$ 1,015.0	\$ 1,015.0	9.7%	\$ 1,015.0	\$ 1,015.0	7.8%
Publicly issued unsecured notes payable	745.5	745.5	6.7%	880.0	880.0	6.7%
Total notes payable	1,760.5	1,760.5	8.4%	1,895.0	1,895.0	7.3%
Revolving line of credit <sup>(4)</sup>	165.0	50.0	6.3% <sup>(2)</sup>	632.5	50.0	4.3% <sup>(2)</sup>
Total debt	\$ 1,925.5	\$ 1,810.5	8.6% <sup>(3)</sup>	\$ 2,527.5	\$ 1,945.0	7.7% <sup>(3)</sup>

- (1) The weighted average annual interest cost is computed as the (a) annual stated interest on the debt plus any applicable default interest, plus the annual amortization of commitment fees, other facility fees and the amortization of 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. Events of default have occurred and are continuing under the revolving line of credit and private notes which have increased the interest rates by 2.00% in 2009 during the continuance of such events of default.
- (2) The annual interest cost reflects the interest rate payable for borrowings under the revolving line of credit. In addition to the current interest rate payable, annual costs of commitment fees, other facility fees and amortization of debt financing costs related to the line of credit are \$4.6 million and \$8.5 million, respectively, at both June 30, 2009, and December 31, 2008.
- (3) The annual interest cost for total debt includes the annual cost of commitment fees and the amortization of debt financing costs on the revolving line of credit and other facility fees regardless of the amount outstanding on the facility as of the balance sheet date.
- (4) At June 30, 2009 \$62.0 million of the facility was committed for standby letters of credit issued under the credit facility. As of July 17, 2009, the commitments under the facility were reduced to \$115.0 million.
- (5) During the third quarter of 2009, we repaid \$100 million of our privately issued unsecured notes payable.

**Revolving Line of Credit.** We have an unsecured revolving line of credit that expires on April 11, 2011. At June 30, 2009, there was \$50.0 million outstanding under our revolving line of credit and standby letters of credit of \$62.0 million were issued under the credit facility. As of July 17, 2009, the commitments under the facility were reduced to \$115.0 million.

Borrowings under the revolving line of credit generally bear interest at a rate per annum equal to (i) LIBOR (for the period selected by us) plus 3.00% or (ii) the higher of (a) the Federal Funds rate plus 1.50% or (b) the Bank of America N.A. prime rate plus 1.00%. The revolving line of credit requires the payment of an annual commitment fee equal to 0.50% of the committed amount (whether used or unused). The revolving line of credit generally requires payments of interest at the end of each LIBOR interest period, but no less frequently than quarterly, on LIBOR-based loans, and monthly payments of interest on other loans. All principal is due upon maturity.

The revolving credit facility provides for a swingline sub-facility. The swingline sub-facility bears interest at the Bank of America N.A. cost of funds plus 2.00%. The revolving credit facility also provides for a sub-facility for the issuance of letters of credit for up to an aggregate amount of \$115.0 million. The letter of credit fee is 3.00% per annum on letters of credit issued, which is payable quarterly. Events of default have occurred which have increased the interest rate and fees on letters of credit by up to 2.00% during the continuance of such events of default. See Events of Default, Liquidity and Operations above.

***Privately Issued Unsecured Notes Payable.*** We have privately issued unsecured long-term notes to institutional investors, primarily insurance companies. The private notes have five- or seven-year maturities and fixed rates of interest ranging from 6.53% to 9.14% at June 30, 2009. Events of default have occurred, which has increased these interest rates by 2.00% during the continuance of such events of default. See Events of Default, Liquidity and Operations above. The private notes generally require payment of interest only semi-annually, and all principal is due upon maturity. At June 30, 2009, the notes had contractual maturities from November 2009 to June 2015. The private notes may be prepaid in whole or in part, together with an interest premium, if any, as stipulated in the note agreements.

The revolving line of credit and the private notes have similar financial and operating covenants. These covenants require us to maintain certain financial ratios, including asset coverage, debt to equity and interest coverage, and a minimum net worth. These debt agreements provide for customary events of default, including, but not limited to,

payment defaults, breach of representations or covenants, crossdefaults, bankruptcy events, failure to pay judgments, attachment of our assets, change of control and the issuance of an order of dissolution. Certain of these events of default are subject to notice and cure periods or materiality thresholds. These debt agreements limit our ability to declare dividends or repurchase our common stock during the existence of certain defaults and events of default.

**Amendments to Revolving Line of Credit and Privately Issued Unsecured Notes Payable.** On December 30, 2008, we entered into amendments relating to our private notes and revolving line of credit. The amendments reduced our capital maintenance covenant to the greater of \$1.5 billion and 85% of consolidated adjusted debt, and reduced our interest charges coverage ratio covenant, determined as of the last day of each fiscal quarter for the period of four consecutive fiscal quarters ending on such day, to 1.4 to 1 for each fiscal quarter to and including the fiscal quarter ending December 31, 2009, to 1.6 to 1 for the fiscal quarter ending March 31, 2010 and each fiscal quarter thereafter to and including the fiscal quarter ending December 31, 2010, and to 1.7 to 1 for the fiscal quarter ending March 31, 2011 and each fiscal quarter thereafter. The amendments did not modify our obligation to maintain a minimum 200% asset coverage ratio.

The amendments added new covenants that required us to grant to the private noteholders (the noteholders) and the revolving line of credit lenders (the lenders) a first lien security interest on substantially all of our assets no later than January 30, 2009, and to maintain a ratio of consolidated total adjusted assets to secured debt of not less than 2.25 to 1. Also, prior to December 31, 2010, the amendments (i) required us to limit the payment of dividends to a maximum of \$0.20 per share per fiscal quarter (or such greater amount required for us to maintain our regulated investment company status), and (ii) restricted us from purchasing, redeeming or retiring any shares of our common stock or any warrants, rights or options to purchase or acquire any shares of our common stock for an aggregate consideration in excess of \$60 million. In addition, the amendments restricted us from prepaying, redeeming, purchasing or otherwise acquiring any of our currently outstanding public notes prior to their stated maturity. The amendments also made certain other modifications. The amendments increased the rate of interest on the instruments by 100 basis points. In addition, these amendments required a 50 basis point amendment fee.

**Publicly Issued Unsecured Notes Payable.** At June 30, 2009, we had outstanding publicly issued unsecured notes as follows:

(\$ in millions)	Amount	Maturity Date
6.625% Notes due 2011	\$ 319.9	July 15, 2011
6.000% Notes due 2012	195.6	April 1, 2012
6.875% Notes due 2047	230.0	April 15, 2047
Total	\$ 745.5	

The 6.625% Notes due 2011 and the 6.000% Notes due 2012 require payment of interest only semi-annually, and all principal is due upon maturity. We have the option to redeem these notes in whole or in part, together with a redemption premium, if any, as stipulated in the notes. In addition, we may purchase these notes in the market at par or at a discount to the extent permitted by the 1940 Act. During the six months ended June 30, 2009, we paid \$30.1 million to repurchase certain of the 6.625% Notes due 2011 which had a face value of \$80.1 million and we paid \$20.2 million to repurchase certain of the 6.000% Notes due 2012 which had a face value of \$54.4 million.

The 6.875% Notes due 2047 require payment of interest only quarterly, and all principal is due upon maturity. We may redeem these notes in whole or in part at any time or from time to time on or after April 15, 2012, at par and upon

the occurrence of certain tax events as stipulated in the notes. The notes are listed on the New York Stock Exchange under the trading symbol AFC.

We have certain financial and operating covenants that are required by the publicly issued unsecured notes payable. We are not permitted to issue indebtedness unless immediately after such issuance we have asset coverage of all outstanding indebtedness of at least 200% as required by the 1940 Act, as amended. At June 30, 2009, our asset coverage ratio was 174%, which is less than the 200% requirement. As a result under the publicly issued unsecured

notes payable, we will not be able to issue indebtedness until such time as our asset coverage returns to at least 200%. We have not experienced any default or cross default with respect to the publicly issued unsecured notes payable.

**Contractual Obligations.** The following table shows our significant contractual obligations for the repayment of debt and payment of other contractual obligations as of June 30, 2009.

(\$ in millions)	Payments Due By Year						
	Total	2009	2010	2011	2012	2013	After 2013
Privately issued unsecured notes payable <sup>(1)</sup>	\$ 1,015.0	\$ 1,015.0	\$	\$	\$	\$	\$
Publicly issued unsecured notes payable	745.5			319.9	195.6		230.0
Revolving line of credit <sup>(2)</sup>	50.0	50.0					
Operating leases	13.0	2.3	4.4	1.7	1.7	1.7	1.2
Total contractual obligations	\$ 1,823.5	\$ 1,067.3	\$ 4.4	\$ 321.6	\$ 197.3	\$ 1.7	\$ 231.2

(1) The private notes have stated contractual maturities as follows: 2009 \$252.5 million, 2010 \$408.0 million, 2011 \$72.5 million, 2012 \$89.0 million, 2013 \$140.5 million and thereafter \$52.5 million. In the third quarter of 2009, we repaid \$100.0 million, which reduced each of the private notes on a pro rata basis. See below.

(2) At June 30, 2009, \$50.0 million was borrowed on the revolving line of credit and \$62.0 million of standby letters of credit were issued under the credit facility. In March 2009, the commitment under our unsecured revolving line of credit was reduced to \$165.0 million, and in July 2009, the commitment under our unsecured revolving line of credit was reduced to \$115.0 million. See Revolving Line of Credit above.

As discussed above, events of default have occurred and are continuing under the revolving line of credit and private notes. See Events of Default, Liquidity and Operations. Neither the lenders nor noteholders have accelerated repayment; however, if the administrative agent for the lenders under the revolving line of credit or the required percentage of lenders under the revolving line of credit or noteholders under the private notes, respectively, were to accelerate repayment, these obligations would become immediately due and payable. Therefore, in the table above, the private notes and revolving line of credit are shown as payable in 2009.

### Off-Balance Sheet Arrangements

In the ordinary course of business, we have issued guarantees and have extended standby letters of credit through financial intermediaries on behalf of certain portfolio companies. We generally have issued guarantees and have obtained standby letters of credit under our revolving line of credit for the benefit of counterparties to certain portfolio companies. Under these arrangements, we would be required to make payments to third parties if the portfolio companies were to default on their related payment obligations or if the expiration dates of the letters of credit are not extended. The following table shows our guarantees and standby letters of credit that may have the effect of creating, increasing, or accelerating our liabilities as of June 30, 2009.

### Amount of Commitment Expiration Per Year

(\$ in millions)	<b>Total</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>After 2013</b>
Guarantees	\$ 19.2	\$ 7.5	\$ 6.4	\$ 4.4	\$ 0.1	\$	\$ 0.8
Standby letters of credit	62.0	62.0					
Total commitments	\$ 81.2	\$ 69.5	\$ 6.4	\$ 4.4	\$ 0.1	\$	\$ 0.8

Standby letters of credit have been issued under our revolving line of credit. Our asset coverage ratio is currently less than 200% and events of default have occurred and are continuing under our revolving line of credit. Therefore, we are precluded from borrowing under our revolving line of credit to fund these standby letters of credit. During the existence of an event of default, the administrative agent is (i) permitted to require us to provide cash collateral equal to the face amount of all outstanding standby letters of credit and (ii) not required to extend the existing letters of credit beyond their maturity dates, all of which expire by October 2009. We expect that the remaining letters of credit



will not be extended by the issuer and that we will need to fund with cash up to the full amount of the remaining standby letters of credit on or prior to their maturity unless we are able to obtain replacement standby letters of credit. The remaining standby letters of credit mature by the end of October 2009. As a result, in the table above we have assumed that these standby letters of credit will not be extended and will mature in 2009. There can be no assurance that we will have cash resources sufficient to satisfy these commitments should the standby letters of credit not be extended.

In addition, we had outstanding commitments to fund investments totaling \$568.4 million at June 30, 2009, including \$537.1 million related to private finance investments and \$31.3 million related to commercial real estate finance investments. Outstanding commitments related to private finance investments included \$352.2 million to the Senior Secured Loan Fund LLC. Investments made by the Senior Secured Loan Fund must be approved by the investment committee of the Senior Secured Loan Fund, which includes a representative from us and GE. Therefore, our commitment to the Senior Secured Loan Fund cannot be drawn without our approval. See Portfolio and Investment Activity Outstanding Commitments above.

We intend to fund these commitments with existing cash and through cash flow from operations before new investments although there can be no assurance that we will generate sufficient cash flow to satisfy these commitments. Should we not be able to satisfy these commitments, there could be a material adverse effect on our financial condition, liquidity and results of operations.

## **CRITICAL ACCOUNTING POLICIES**

The consolidated financial statements are based on the selection and application of critical accounting policies, which require management to make significant estimates and assumptions. Critical accounting policies are those that are both important to the presentation of our financial condition and results of operations and require management's most difficult, complex, or subjective judgments. Our critical accounting policies are those applicable to the valuation of investments, certain revenue recognition matters and certain tax matters as discussed below.

***Valuation of Portfolio Investments.*** We, as a BDC, have invested in illiquid securities including debt and equity securities of portfolio companies, CLO bonds and preferred shares/income notes, CDO bonds and investment funds. Our investments may be subject to certain restrictions on resale and generally have no established trading market. We value substantially all of our investments at fair value as determined in good faith by the Board of Directors in accordance with our valuation policy and the provisions of the Investment Company Act of 1940 and FASB Statement No. 157, *Fair Value Measurements* (SFAS 157 or the Statement) and related interpretations. We determine fair value to be the price that would be received for an investment in a current sale, which assumes an orderly transaction between market participants on the measurement date. Our valuation policy considers the fact that no ready market exists for substantially all of the securities in which it invests and that fair value for its investments must typically be determined using unobservable inputs. Our valuation policy is intended to provide a consistent basis for determining the fair value of the portfolio.

We adopted SFAS 157 on a prospective basis in the first quarter of 2008. SFAS 157 requires us to assume that the portfolio investment is to be sold in the principal market to market participants, or in the absence of a principal market, the most advantageous market, which may be a hypothetical market. Market participants are defined as buyers and sellers in the principal or most advantageous market that are independent, knowledgeable, and willing and able to transact. In accordance with the Statement, we have considered our principal market, or the market in which we exit our portfolio investments with the greatest volume and level of activity.

We have determined that for our buyout investments, where we have control or could gain control through an option or warrant security, both the debt and equity securities of the portfolio investment would exit in the merger and

acquisition (M&A) market as the principal market generally through a sale or recapitalization of the portfolio company. We believe that the in-use premise of value (as defined in SFAS 157), which assumes the debt and equity securities are sold together, is appropriate as this would provide maximum proceeds to the seller. As a result, we use the enterprise value methodology to determine the fair value of these investments under SFAS 157. Enterprise value

means the entire value of the company to a market participant, including the sum of the values of debt and equity securities used to capitalize the enterprise at a point in time. Enterprise value is determined using various factors, including cash flow from operations of the portfolio company, multiples at which private companies are bought and sold, 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. We allocate the enterprise value to these securities in order of the legal priority of the securities.

While we typically exit our securities upon the sale or recapitalization of the portfolio company in the M&A market, for investments in portfolio companies where we do not have control or the ability to gain control through an option or warrant security, we cannot typically control the exit of our investment into our principal market (the M&A market). As a result, in accordance with SFAS 157, we are required to determine the fair value of these investments assuming a sale of the individual investment (the in-exchange premise of value) in a hypothetical market to a hypothetical market participant. We continue to perform an enterprise value analysis for the investments in this category to assess the credit risk of the loan or debt security and to determine the fair value of our equity investment in these portfolio companies. The determined equity values are generally discounted when we have a minority ownership position, restrictions on resale, specific concerns about the receptivity of the capital markets to a specific company at a certain time, or other factors. For loan and debt securities, we perform a yield analysis assuming a hypothetical current sale of the investment. The yield analysis requires us to estimate the expected repayment date of the instrument and a market participant's required yield. Our estimate of the expected repayment date of a loan or debt security may be shorter than the legal maturity of the instruments as our loans historically have been repaid prior to the maturity date. The yield analysis considers changes in interest rates and changes in leverage levels of the loan or debt security as compared to market interest rates and leverage levels. Assuming the credit quality of the loan or debt security remains stable, we will use the value determined by the yield analysis as the fair value for that security. A change in the assumptions that we use to estimate the fair value of our loans and debt securities using a yield analysis could have a material impact on the determination of fair value. If there is deterioration in credit quality or a loan or debt security is in workout status, we may consider other factors in determining the fair value of a loan or debt security, including the value attributable to the loan or debt security from the enterprise value of the portfolio company or the proceeds that would be received in a liquidation analysis.

Our equity investments in private debt and equity funds are generally valued based on the fund's net asset value, unless other factors lead to a determination of fair value at a different amount. The value of our equity securities in public companies for which quoted prices in an active market are readily available is based on the closing public market price on the measurement date.

The fair value of our CLO bonds and preferred shares/income notes and CDO bonds (CLO/CDO Assets) is generally based on a discounted cash flow model that utilizes prepayment, re-investment, loss and ratings 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 CLO/CDO Assets as comparable yields in the market change and/or based on changes in estimated cash flows resulting from changes in prepayment, re-investment, loss or ratings assumptions in the underlying collateral pool or changes in redemption assumptions for the CLO/CDO Assets, if applicable. We determine the fair value of our CLO/CDO Assets on an individual security-by-security basis.

We record unrealized depreciation on investments when we determine that the fair value of a security is less than its cost basis, and record unrealized appreciation when we determine that the fair value is greater than its cost basis. Because of the inherent uncertainty of valuation, the values determined at the measurement date 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. Additionally, changes in the market environment and other events that may occur over the life of the investments may cause the gains or losses ultimately realized on these investments to be different than

the values determined at the measurement date. In accordance with FSP 157-4 (discussed below), we do not consider a transaction price that is associated with a transaction that is not orderly to be indicative of fair value or market

participant risk premiums, and accordingly would place little, if any, weight on transactions that are not orderly in determining fair value. When considering recent potential or completed transactions, we use judgment in determining if such offers or transactions were pursuant to an orderly process for purposes of determining how much weight is placed on these data points in accordance with the applicable guidelines in SFAS 157 and FSP 157-4.

See Results of Operations Change in Unrealized Appreciation or Depreciation above for more discussion on portfolio valuation.

***Net Realized Gains or Losses and Net Change in Unrealized Appreciation or Depreciation.*** Realized gains or losses are measured by the difference between the net proceeds from the repayment or sale and the cost basis of the investment without regard to unrealized appreciation or depreciation previously recognized, and include investments charged off during the period, net of recoveries. Net change in unrealized appreciation or depreciation primarily reflects the change in portfolio investment values during the reporting period, including the reversal of previously recorded unrealized appreciation or depreciation when gains or losses are realized. Net change in unrealized appreciation or depreciation also reflects the change in the value of U.S. Treasury bills, when applicable, and depreciation on accrued interest and dividends receivable and other assets where collection is doubtful.

***Interest and Dividend Income.*** Interest income is recorded on an accrual basis to the extent that such amounts are expected to be collected. For loans and debt securities with contractual payment-in-kind interest, which represents contractual interest accrued and added to the loan balance that generally becomes due at maturity, we will not accrue payment-in-kind interest if the portfolio company valuation indicates that the payment-in-kind interest is not collectible. 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. Interest may not accrue on loans or debt securities to portfolio companies that are more than 50% owned by us depending on such company's capital requirements.

When we receive nominal cost warrants or free equity securities (nominal cost equity), we allocate our cost basis in our investment between debt securities and nominal cost equity at the time of origination. At that time, the original issue discount basis of the nominal cost equity is recorded by increasing the cost basis in the equity and decreasing the cost basis in the related debt securities. Loan origination fees, original issue discount, and market discount are capitalized and then amortized into interest income using a method that approximates the effective interest method. Upon the prepayment of a loan or debt security, any unamortized loan origination fees are recorded as interest income and any unamortized original issue discount or market discount is recorded as a realized gain.

We recognize interest income on the CLO preferred shares/income notes using the effective interest method, based on the anticipated yield that is determined using the estimated cash flows over the projected life of the investment. Yields are revised when there are changes in actual or estimated cash flows due to changes in prepayments and/or re-investments, credit losses, ratings or asset pricing. Changes in estimated yield are recognized as an adjustment to the estimated yield over the remaining life of the preferred shares/income notes from the date the estimated yield was changed. CLO and CDO bonds have stated interest rates. The weighted average yield on the CLO/CDO Assets is calculated as the (a) annual stated interest or the effective interest yield on the accruing bonds or the effective yield on the preferred shares/income notes, divided by (b) CLO/CDO Assets at value. The weighted average yields are computed as of the balance sheet date.

Dividend income on preferred equity securities is recorded as dividend income on an accrual basis to the extent that such amounts are expected to be collected and to the extent that we have the option to receive the dividend in cash. Dividend income on common equity securities is recorded on the record date for private companies or on the ex-dividend date for publicly traded companies.

**Fee Income.** Fee income includes fees for loan prepayment premiums, guarantees, commitments, and services rendered by us to portfolio companies and other third parties such as diligence, structuring, transaction services, management and consulting services, and other services. Loan prepayment premiums are recognized at the time of prepayment. Guaranty and commitment fees are generally recognized as income over the related period of the guaranty or commitment, respectively. Diligence, structuring, and transaction services fees are generally recognized as income when services are rendered or when the related transactions are completed. Management, consulting and

other services fees, including fund management fees, are generally recognized as income as the services are rendered. Fees are not accrued if we have doubt about collection of those fees.

***Federal and State Income Taxes and Excise Tax.*** We intend to comply with the requirements of the Internal Revenue Code that are applicable to regulated investment companies (RIC) and real estate investment trusts (REIT). We and any of our subsidiaries that qualify as a RIC or a REIT intend to distribute or retain through a deemed distribution all of our annual taxable income to shareholders; therefore, we have made no provision for income taxes for these entities.

If we do not distribute at least 98% of our annual taxable income in the year earned, we will generally be required to pay an excise tax equal to 4% of the amount by which 98% of our annual taxable income exceeds the distributions from such taxable income for the year. To the extent that we determine that our estimated current year annual taxable income will be in excess of estimated current year dividend distributions from such taxable income, we accrue excise taxes, if any, on estimated excess taxable income as taxable income is earned using an annual effective excise tax rate. The annual effective excise tax rate is determined by dividing the estimated annual excise tax by the estimated annual taxable income.

Income taxes for AC Corp are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases as well as operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

***Recent Accounting Pronouncements. Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*** (FSP 157-4). In April 2009, the FASB issued FSP 157-4, which provides guidance on how to determine the fair value of assets under SFAS 157 in the current economic environment and reemphasizes that the objective of a fair-value measurement remains an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. FSP 157-4 states that a transaction price that is associated with a transaction that is not orderly is not determinative of fair value or market-participant risk premiums and companies should place little, if any, weight (compared with other indications of fair value) on transactions that are not orderly when estimating fair value or market risk premiums.

We adopted the provisions of FSP 157-4 on a prospective basis beginning in the quarter ending March 31, 2009. The adoption of the provisions of FSP 157-4 did not have a material effect on our consolidated financial statements.

***Fair Value Measurements.*** In September 2006, the FASB issued Statement No. 157, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements.

We adopted this statement on a prospective basis beginning in the quarter ended March 31, 2008. The initial adoption of this statement did not have a material effect on our consolidated financial statements.

***Subsequent Events*** (SFAS 165). In May 2009, the FASB issued SFAS 165 which establishes general standards for reporting events that occur after the balance sheet date, but before financial statements are issued or are available to be issued. SFAS 165 requires the disclosure of the date through which an entity has evaluated subsequent events and whether that date represents the date the financial statements were issued or were available to be issued.

We adopted the provisions of SFAS 165 in the quarter ended June 30, 2009. The adoption of FAS 165 did not have a material impact on our financial statements.

*Accounting for Transfers of Financial Assets (SFAS 166).* In June 2009, the FASB issued SFAS 166, which changes the conditions for reporting a transfer of a portion of a financial asset as a sale and requires additional year-end and interim disclosures. SFAS 166 is effective for fiscal years beginning after November 15, 2009.

The implementation of SFAS 166 is not expected to have a material impact on our financial statements.

*The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles (SFAS 168).* In July 2009, the FASB issued SFAS 168, which supersedes SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles*. SFAS 168 establishes the FASB Accounting Standards Codification, which will



become the source of authoritative U.S. generally accepted accounting principles recognized by the FASB. SFAS 168 is effective for the period ending after September 15, 2009.

The implementation of SFAS 168 is not expected to have a material impact on our financial statements.

**Item 3. *Quantitative and Qualitative Disclosures About Market Risk***

There has been no material change in quantitative or qualitative disclosures about market risk since December 31, 2008.

**Item 4. *Controls and Procedures***

(a) As of the end of the period covered by this quarterly report on Form 10-Q, the Company's chairman of the board, chief executive officer, chief financial officer and chief accounting officer conducted an evaluation of the Company's disclosure controls and procedures (as defined in Rules 13a-15 and 15d-15 of the Securities Exchange Act of 1934). Based upon this evaluation, the Company's chairman of the board, chief executive officer, chief financial officer and chief accounting officer concluded that the Company's disclosure controls and procedures are effective to allow timely decisions regarding required disclosure of any material information relating to the Company that is required to be disclosed by the Company in the reports it files or submits under the Securities Exchange Act of 1934.

(b) There have been no changes in the Company's internal control over financial reporting that occurred during the quarter ended June 30, 2009, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## PART II. OTHER INFORMATION

### Item 1. *Legal Proceedings*

On June 23, 2004, we were notified by the SEC that they were conducting an informal investigation of us. The investigation related to the valuation of securities in our private finance portfolio and other matters. On June 20, 2007, we announced that we entered into a settlement with the SEC that resolved the SEC's informal investigation. As part of the settlement and without admitting or denying the SEC's allegations, we agreed to the entry of an administrative order. In the order the SEC alleged that, between June 30, 2001, and March 31, 2003, we did not maintain books, records and accounts which, in reasonable detail, supported or accurately and fairly reflected valuations of certain securities in our private finance portfolio and, as a result, did not meet certain recordkeeping and internal controls provisions of the federal securities laws. In the administrative order, the SEC ordered us to continue to maintain certain of our current valuation-related controls. Specifically, for a period of two years, we have undertaken to: (1) continue to employ a Chief Valuation Officer, or a similarly structured officer-level employee, to oversee our quarterly valuation processes; and (2) continue to employ third-party valuation consultants to assist in our quarterly valuation processes.

On December 22, 2004, we received letters from the U.S. Attorney for the District of Columbia requesting the preservation and production of information regarding us and Business Loan Express, LLC (currently known as Ciena Capital LLC) in connection with a criminal investigation relating to matters similar to those investigated by and settled with the SEC as discussed above. We produced materials in response to the requests from the U.S. Attorney's office and certain current and former employees were interviewed by the U.S. Attorney's Office. We have voluntarily cooperated with the investigation.

In late December 2006, we received a subpoena from the U.S. Attorney for the District of Columbia requesting, among other things, the production of records regarding the use of private investigators by us or our agents. The Board established a committee, which was advised by its own counsel, to review this matter. In the course of gathering documents responsive to the subpoena, we became aware that an agent of Allied Capital obtained what were represented to be telephone records of David Einhorn and which purport to be records of calls from Greenlight Capital during a period of time in 2005. Also, while we were gathering documents responsive to the subpoena, allegations were made that our management had authorized the acquisition of these records and that management was subsequently advised that these records had been obtained. Our management has stated that these allegations are not true. We have cooperated fully with the inquiry by the U.S. Attorney's Office.

On February 26, 2007, Dana Ross filed a class action complaint in the U.S. District Court for the District of Columbia in which she alleges that Allied Capital Corporation and certain members of management violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. Thereafter, the court appointed new lead counsel and approved new lead plaintiffs. On July 30, 2007, plaintiffs served an amended complaint. Plaintiffs claim that, between November 7, 2005, and January 22, 2007, Allied Capital either failed to disclose or misrepresented information about our portfolio company, Business Loan Express, LLC. Plaintiffs seek unspecified compensatory and other damages, as well as other relief. We believe the lawsuit is without merit, and we intend to defend the lawsuit vigorously. On September 13, 2007, we filed a motion to dismiss the lawsuit. A hearing was held on the motion to dismiss in April 2009. The motion is pending.

On October 6, 2008, Rena Nadoff filed a shareholder derivative action in the Superior Court of the District of Columbia, captioned *Rena Nadoff v. Walton, et al.*, 2008 CA 007108, seeking unspecified compensatory and other damages, as well as equitable relief on behalf of Allied Capital Corporation. Ms. Nadoff's suit is substantially similar

to a derivative action she filed in February 2007, which the Court dismissed in July 2007. On November 26, 2008, we filed a motion to dismiss the second Nadoff lawsuit. On February 3, 2009, the Court denied the motion to dismiss but ordered Ms. Nadoff to file an amended complaint that clearly identifies and sets forth the breaches of fiduciary duty, if any, that are alleged to have occurred after the filing (or dismissal) of the first Nadoff derivative lawsuit. Ms. Nadoff filed an amended complaint alleging breaches of fiduciary duty by the Board of Directors. We

filed a motion to dismiss the amended complaint. On May 21, 2009, the Court granted the motion and dismissed the amended complaint.

In addition to the above matters, we are party to certain lawsuits in the normal course of business. Furthermore, third parties may try to seek to impose liability on us in connection with the activities of our portfolio companies. For a discussion of civil investigations being conducted regarding the lending practices of Ciena Capital LLC, one of our portfolio companies, see Note 3, Portfolio Ciena Capital LLC from our Notes to the Consolidated Financial Statements included in Item 1.

While the outcome of any of the open legal proceedings described above cannot at this time be predicted with certainty, we do not expect these matters will materially affect our financial condition or results of operations; however, there can be no assurance whether any pending legal proceedings will have a material adverse effect on our financial condition or results of operations in any future reporting period.

#### **Item 1A. Risk Factors.**

*Investing in Allied Capital involves a number of significant risks relating to our business and investment objective. As a result, there can be no assurance that we will achieve our investment objective.*

#### **Risks Related to Liquidity**

**Certain events of default have occurred under our revolving credit facility and our private notes and, as a result, these lenders are permitted to accelerate repayment of the outstanding obligations thereunder.** Certain events of default have occurred under our revolving credit facility and our private notes. The occurrence of an event of default permits the administrative agent for the lenders under the revolving credit facility, or the holders of more than 51% of the commitments under the revolving credit facility, to accelerate repayment of all amounts due, to terminate commitments thereunder, and to require us to provide cash collateral equal to the face amount of all outstanding letters of credit. Pursuant to the terms of the private notes, the occurrence of an event of default permits the holders of 51% or more of any issue of outstanding private notes to accelerate repayment of all amounts due thereunder.

As of June 30, 2009 we had \$50.0 million in outstanding borrowings and \$62.0 million in outstanding letters of credit issued under the revolving credit facility, and \$1.0 billion in outstanding private notes. Neither the lenders nor the noteholders have accelerated repayment of our obligations; however, there can be no assurance that they will not accelerate repayment in the future. We do not have sufficient cash resources to repay these obligations should the lenders or noteholders accelerate these obligations. Acceleration of the amounts outstanding under the revolving credit facility or any issue of the private notes could have a material adverse impact on our liquidity, financial condition and operations.

The existence of an event of default restricts us from borrowing or obtaining letters of credit under our revolving credit facility, and from declaring dividends or other distributions to our shareholders.

In July 2009, we agreed in principle to terms with the revolving line of credit lenders and the private noteholders on a comprehensive restructuring of these debt agreements. In connection with these restructuring discussions, we repaid \$100 million of the outstanding private notes in the third quarter of 2009. The terms of the restructuring are non-binding and remain subject to final documentation and closure. There can be no assurance of the timing of any debt restructuring or that we will complete a restructuring of our debt. Until the restructuring is completed, this debt remains subject to acceleration.

**Our independent registered public accounting firm has expressed substantial doubt about our ability to continue as a going concern.** In its audit report on our financial statements for our fiscal year ended December 31, 2008, our independent registered public accounting firm included an explanatory paragraph indicating that our consolidated financial statements have been prepared assuming that we will continue as a going concern. Certain

events of default have occurred under our revolving credit facility and our private notes. These events of default provide the respective lenders the right to declare immediately due and payable unpaid amounts approximating \$1.1 billion at June 30, 2009. We do not have available cash resources to satisfy all of the obligations under the revolving credit facility and the private notes should the lenders accelerate these obligations. These factors raise substantial doubt about our ability to continue as a going concern. The consolidated financial statements do not include any adjustments that might result from the outcome of these uncertainties.

**Our use of leverage magnifies the potential for gain or loss on amounts invested and may increase the risk of investing in us.** Borrowings, also known as leverage, magnify the potential for gain or loss on amounts invested and, therefore, increase the risks associated with investing in our securities. We borrow from and issue senior debt securities to banks, insurance companies, and other lenders or investors. Holders of these senior securities have fixed dollar claims on our consolidated assets that are superior to the claims of our common shareholders. If the value of our consolidated assets increases, then leveraging would cause the net asset value attributable to our common stock to increase more sharply than it would have had we not leveraged. Conversely, if the value of our consolidated assets decreases, leveraging would cause net asset value to decline more sharply than it otherwise would have had we not leveraged. Similarly, any increase in our consolidated income in excess of consolidated interest payable on the borrowed funds would cause our net income to increase more than it would without the leverage, while any decrease in our consolidated income would cause net income to decline more sharply than it would have had we not borrowed. Leverage is generally considered a speculative investment technique. We and, indirectly, our stockholders will bear the cost associated with our leverage activity. Our revolving line of credit and notes payable contain financial and operating covenants that could restrict our business activities, including our ability to declare dividends if we default under certain provisions. Breach of any of those covenants could cause a default under those instruments. Such a default, if not cured or waived, could have a material adverse effect on us.

At June 30, 2009, we had \$1.8 billion of outstanding indebtedness bearing a weighted average annual interest cost of 8.6% and a debt to equity ratio of 1.35 to 1.00. If our portfolio of investments fails to produce adequate returns, we may be unable to make interest or principal payments on our indebtedness when they are due. In order for us to cover annual interest payments on indebtedness, we must achieve annual returns on our assets of at least 4.9% as of June 30, 2009, which returns were achieved.

**Regulations governing our operation as a BDC affect our ability to, and the way in which we, raise additional debt and equity capital.** We will continue to need capital to fund growth in our investments. Under the 1940 Act, we are not permitted to issue indebtedness unless immediately after such borrowing we have an asset coverage for total borrowings of at least 200%. As of June 30, 2009, our asset coverage was 174%. There can be no assurance as to when we will be able to satisfy the asset coverage requirements of the 1940 Act, if at all, and our failure to do so would have a material adverse impact on our liquidity, financial condition, results of operations, and ability to pay dividends.

We generally are not able to issue and sell our common stock at a price below net asset value per share. We may, however, sell our common stock, warrants, options, or rights to acquire our common stock at a price below the current net asset value per share of the common stock if our Board of Directors determines that such sale is in our best interests and the best interests of our stockholders and, in certain instances, our stockholders approve such sale. In any such case, the price at which our securities are to be issued and sold may not be less than the price which, in the determination of our Board of Directors, closely approximates the market value of such securities (less any commission or discount). If our common stock continues to trade at a discount to net asset value, this restriction could adversely affect our ability to raise capital. Shares of business development companies, including shares of our common stock, have been trading at discounts to their net asset values. As of June 30, 2009, our net asset value per share was \$7.49. The closing price of our shares on the NYSE at June 30, 2009 was \$3.48. If our common stock trades below net asset value, the higher cost of equity capital may result in it being unattractive to raise new equity, which

may limit our ability to grow. The risk of trading below net asset value is separate and distinct from the risk that our net asset value per share may decline.

**Our credit ratings may change and may not reflect all risks of an investment in the debt securities.** At June 30, 2009, our long-term debt carries a non-investment grade credit rating of B1 by Moody's Investors Service, BB+ by Standard & Poor's, and BB by FitchRatings. Our credit ratings are an assessment of our ability to pay our obligations. Consequently, real or anticipated changes in our credit ratings will generally affect the market value of the publicly issued debt securities. There can be no assurance that the long-term debt ratings will be maintained.

### **Risks Related to Current Economic and Market Conditions**

**We are currently in a period of capital markets disruption and severe recession and we do not expect these conditions to improve in the near future. These market conditions have materially and adversely affected the debt and equity capital markets in the United States, which has had and could continue to have a negative impact on our business and operations.** The U.S. capital markets have been experiencing extreme volatility and disruption for more than 12 months as evidenced by a lack of liquidity in the debt capital markets, significant write-offs in the financial services sector, the repricing of credit risk in the credit market and the failure of major financial institutions. These events have contributed to worsening general economic conditions that are materially and adversely impacting the broader financial and credit markets and reducing the availability of credit and equity capital for the markets as a whole and financial services firms in particular. We believe that the U.S. economy has entered into a period of severe recession, and forecasts for 2009 generally call for a weakening economy in the United States, with the continuation of the economic recession and possibly an economic depression. As a result, we believe these conditions may continue for a prolonged period of time or worsen in the future. A prolonged period of market illiquidity will continue to have an adverse effect on our business, financial condition, and results of operations. Unfavorable economic conditions also could increase our funding costs, limit our access to the capital markets or result in a decision by lenders not to extend credit to us. Equity capital may be difficult to raise because, subject to some limited exceptions, we generally are not able to issue and sell our common stock at a price below net asset value per share. In addition, the debt capital that will be available, if at all, may be at a higher cost and on less favorable terms and conditions. These events and the inability to raise capital has significantly limited our investment originations, limited our ability to grow and negatively impacted our operating results.

**Economic recessions, including the current global recession, could impair our portfolio companies and harm our operating results.** Many of the companies in which we have made or will make investments are susceptible to economic slowdowns or recessions. An economic recession, including the current and any future recessions or economic slowdowns, may affect the ability of a company to repay our loans or engage in a liquidity event such as a sale, recapitalization, or initial public offering. Our nonperforming assets are likely to increase and the value of our portfolio is likely to decrease during these periods. Current adverse economic conditions also have decreased the value of any collateral securing our loans, if any, and a prolonged recession or depression may further decrease such value. These conditions are contributing to and if prolonged could lead to further losses of value in our portfolio and a decrease in our revenues, net income, assets and net worth.

### **Risks Related to Asset Values**

**Declining asset values and illiquidity in the corporate debt markets have adversely affected, and may continue to adversely affect, the fair value of our portfolio investments, reducing the value of our assets.** As a BDC, we are required to carry our investments at market value or, if no market value is readily available, at fair value as determined in good faith by the Board of Directors. Decreases in the values of our investments are recorded as unrealized depreciation. The continuing unprecedented declines in asset values and liquidity in the corporate debt markets have resulted in significant net unrealized depreciation in our portfolio. As of June 30, 2009, conditions in the debt and equity markets had continued to deteriorate and pricing levels continued to decline. As a result, we have incurred and, depending on market conditions, we may incur further unrealized depreciation in future periods, which could have a material adverse impact on our business, financial condition and results of operations.





**Substantially all of our portfolio investments, which are generally illiquid, are recorded at fair value as determined in good faith by our Board of Directors and, as a result, there is uncertainty regarding the value of our portfolio investments.** At June 30, 2009, portfolio investments recorded at fair value were 79% of our total assets. Pursuant to the requirements of the 1940 Act, we value substantially all of our investments at fair value as determined in good faith by our Board of Directors on a quarterly basis. Since there is typically no market quotation in an active market for the investments in our portfolio, our Board of Directors determines in good faith the fair value of these investments pursuant to a valuation policy and a consistently applied valuation process.

There is no single approach 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. In determining fair value in good faith, we generally obtain financial and other information from portfolio companies, which may represent unaudited, projected or pro forma financial information. Unlike banks, we are not permitted to provide a general reserve for anticipated loan losses; we are instead required by the 1940 Act to specifically value each individual investment on a quarterly basis. We will record unrealized depreciation on investments when we determine that the fair value of a security is less than its cost basis, and unrealized appreciation when we determine that the fair value of a security is greater than its cost basis. Without a market quotation in an active market and because of the inherent uncertainty of valuation, 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. Our net asset value could be affected if our determination of the fair value of our investments is materially different than the value that we ultimately realize.

We adjust quarterly the valuation of our portfolio to reflect the Board of Directors' determination of the fair value of each investment in our portfolio. Any changes in fair value are recorded in our statement of operations as net change in unrealized appreciation or depreciation. See Note 2, Summary of Significant Accounting Policies from our Notes to the Consolidated Financial Statements included in Item 1.

### **Risks Related to Our Portfolio**

**Our portfolio of investments is illiquid.** We generally acquire our investments directly from the issuer in privately negotiated transactions. The majority of the investments in our portfolio are subject to certain restrictions on resale or otherwise have no established trading market. We typically exit our investments when the portfolio company has a liquidity event such as a sale, recapitalization, or initial public offering of the company. The illiquidity of our investments may adversely affect our ability to dispose of debt and equity securities at times when we may need to or when it may be otherwise advantageous for us to liquidate such investments. In addition, if we were forced to immediately liquidate some or all of the investments in the portfolio, the proceeds of such liquidation could be significantly less than the current value of such investments.

Our business of making private equity investments and positioning them for liquidity events also may be affected by current and future market conditions. Current economic and capital markets conditions in the U.S. have severely reduced capital availability, senior lending activity and middle market merger and acquisition activity. The absence of an active senior lending environment and the slowdown or stalling in middle market merger and acquisition activity has slowed the amount of private equity investment activity generally. As a result, our investment activity has also slowed. In addition, significant changes in the capital markets, including the recent extreme volatility and disruption, has had and may continue to have a negative effect on the valuations of our investments, and on the potential for liquidity events involving such investments. This could affect the timing of exit events in our portfolio, reduce the level of net realized gains from exit events in a given year, and could negatively affect the amount of gains or losses upon exit.

**Investing in private companies involves a high degree of risk.** Our portfolio primarily consists of long-term loans to and investments in middle market private companies. Investments in private businesses involve a high degree of business and financial risk, which can result in substantial losses for us in those investments and accordingly should be considered speculative. There is generally no publicly available information about the

companies in which we invest, and we rely significantly on the diligence of our employees and agents to obtain information in connection with our investment decisions. If we are unable to identify all material information about these companies, among other factors, we may fail to receive the expected return on our investment or lose some or all of the money invested in these companies. In addition, these businesses may have shorter operating histories, narrower product lines, smaller market shares and less experienced management than their competition and may be more vulnerable to customer preferences, market conditions, loss of key personnel, or economic downturns, which may adversely affect the return on, or the recovery of, our investment in such businesses. As an investor, we are subject to the risk that a portfolio company may make a business decision that does not serve our interest, which could decrease the value of our investment. Deterioration in a portfolio company's financial condition and prospects may be accompanied by deterioration in the collateral for a loan, if any.

**Our borrowers may default on their payments, which may have a negative effect on our financial performance.** We make long-term loans and invest in equity securities primarily in private middle market companies, which may involve a higher degree of repayment risk. We primarily invest in companies that may have limited financial resources, may be highly leveraged and may be unable to obtain financing from traditional sources. Numerous factors may affect a borrower's ability to repay its loan, including the failure to meet its business plan, a downturn in its industry, or negative economic conditions. A portfolio company's failure to satisfy financial or operating covenants imposed by us or other lenders could lead to defaults and, potentially, termination of its loans or foreclosure on its secured assets, which could trigger cross defaults under other agreements and jeopardize our portfolio company's ability to meet its obligations under the loans or debt securities that we hold. In addition, our portfolio companies may have, or may be permitted to incur, other debt that ranks senior to or equally with our securities. This means that payments on such senior-ranking securities may have to be made before we receive any payments on our subordinated loans or debt securities. Deterioration in a borrower's financial condition and prospects may be accompanied by deterioration in any related collateral and may have a negative effect on our financial results.

**We may be unable to fund our commitments to our portfolio companies as they become due, which may have a material adverse effect on our business.** We have outstanding investment commitments that at June 30, 2009 totaled \$568.4 million. In addition, at June 30, 2009, we had standby letters of credit issued under our revolving line of credit and certain guarantees related to portfolio companies of \$62.0 million. We are currently in default under the terms of our revolving line of credit and private notes, and in addition our asset coverage is less than the 200% required by the 1940 Act for us to issue new debt. As a result, we are currently unable to borrow additional money to fund these commitments. In addition, because our common stock trades at a price that is less than our net asset value per share, we may not be able to raise funds through additional equity offerings in order to fund these commitments. To the extent we are unable to fund these commitments, it could have a material adverse effect on our portfolio companies, and as a result, have a material adverse effect on our results of operations.

**Our private finance investments may not produce current returns or capital gains.** Our private finance portfolio includes loans and debt securities that require the payment of interest currently and equity securities such as conversion rights, warrants, or options, minority equity co-investments, or more significant equity investments in the case of buyout transactions. Our private finance debt investments are generally structured to generate interest income from the time they are made and our equity investments may also produce a realized gain. We cannot be sure that our portfolio will generate a current return or capital gains.

**Our financial results could be negatively affected if a significant portfolio investment fails to perform as expected.** Our total investment in companies may be significant individually or in the aggregate. As a result, if a significant investment in one or more companies fails to perform as expected, our financial results could be more negatively affected and the magnitude of the loss could be more significant than if we had made smaller investments in more companies.

At June 30, 2009, our investment in Ciena Capital LLC (Ciena) totaled \$547.6 million at cost and \$93.0 million at value, after the effect of unrealized depreciation of \$454.5 million. Other assets includes additional amounts receivable from or related to Ciena totaling \$66.8 million, which have a value of \$2.0 million at June 30, 2009. In addition, we have provided standby letters of credit, issued in connection with term securitization transactions

completed by Ciena, that totaled \$46.0 million at June 30, 2009, and we issued performance guarantees in connection with two non-recourse warehouse facilities. On September 30, 2008, Ciena voluntarily filed for bankruptcy.

Ciena has been a participant in the SBA's 7(a) Guaranteed Loan Program and its wholly-owned subsidiary is licensed by the SBA as a Small Business Lending Company (SBLC). Ciena remains subject to SBA rules and regulations. The Office of the Inspector General of the SBA (OIG) and the United States Secret Service are conducting ongoing investigations of allegedly fraudulently obtained SBA-guaranteed loans issued by Ciena. Ciena is also subject to other SBA and OIG audits, investigations, and reviews. In addition, the Office of the Inspector General of the U.S. Department of Agriculture is conducting an investigation of Ciena's lending practices under the Business and Industry Loan program. The OIG and the U.S. Department of Justice are also conducting a civil investigation of Ciena's lending practices in various jurisdictions. These investigations, audits, and reviews are ongoing. These investigations, audits, and reviews have had and may continue to have a material adverse impact on Ciena and, as a result, could negatively affect our financial results. See Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations - Private Finance, Ciena Capital LLC.

**We operate in a competitive market for investment opportunities.** We compete for investments with a large number of private equity funds and mezzanine funds, other business development companies, investment banks, other equity and non-equity based investment funds, and other sources of financing, including specialty finance companies and traditional financial services companies such as commercial banks. Some of our competitors may have greater resources than we do. Increased competition would make it more difficult for us to purchase or originate investments at attractive prices. As a result of this competition, sometimes we may be precluded from making otherwise attractive investments.

#### **Risks Related to Regulation as a Business Development Company and Regulated Investment Company**

**Loss of regulated investment company tax treatment could negatively impact our ability to service our debt and pay dividends.** We have operated so as to qualify as a regulated investment company under Subchapter M of the Code. If we meet source of income, asset diversification, and distribution requirements, we generally will not be subject to corporate-level income taxation on income we timely distribute, or deem to distribute, to our shareholders as dividends. We would cease to qualify for such tax treatment if we were unable to comply with these requirements. In addition, we may have difficulty meeting the requirement to make distributions to our shareholders because in certain cases we may recognize income before or without receiving cash representing such income. If we fail to qualify as a regulated investment company, we will have to pay corporate-level taxes on all of our income whether or not we distribute it, which could negatively impact our ability to service our debt and pay dividends to our shareholders. Even if we qualify as a regulated investment company, we generally will be subject to a corporate-level income tax on the income we do not distribute. If we do not distribute at least 98% of our annual taxable income (excluding net long-term capital gains retained or deemed to be distributed) in the year earned, we generally will be required to pay an excise tax on amounts carried over and distributed to shareholders in the next year equal to 4% of the amount by which 98% of our annual taxable income available for distribution exceeds the distributions from such income for the current year.

**Failure to invest a sufficient portion of our assets in qualifying assets could preclude us from investing in accordance with our current business strategy.** As a business development company, we may not acquire any assets other than qualifying assets unless, at the time of and after giving effect to such acquisition, at least 70% of our total assets are qualifying assets. Therefore, we may be precluded from investing in what we believe are attractive investments if such investments are not qualifying assets for purposes of the 1940 Act. If we do not invest a sufficient portion of our assets in qualifying assets, we could lose our status as a business development company, which would have a material adverse effect on our business, financial condition and results of operations. Similarly, these rules could prevent us from making additional investments in existing portfolio companies, which could result in the

dilution of our position, or could require us to dispose of investments at inopportune times in order to comply

with the 1940 Act. If we were forced to sell nonqualifying investments in the portfolio for compliance purposes, the proceeds from such sale could be significantly less than the current value of such investments.

**Changes in the law or regulations that govern us could have a material impact on us or our operations.** We are regulated by the SEC. In addition, changes in the laws or regulations that govern business development companies, regulated investment companies, asset managers, and real estate investment trusts may significantly affect our business. There are proposals being considered by the current administration to change the regulation of financial institutions that may affect, possibly adversely, investment managers or investment funds. Any change in the law or regulations that govern our business could have a material impact on us or our operations. Laws and regulations may be changed from time to time, and the interpretations of the relevant laws and regulations also are subject to change, which may have a material effect on our operations.

### **Risks Related to Our Ability to Pay Dividends to Our Shareholders**

**There is a risk that our common stockholders may not receive dividends or distributions.** We may not be able to achieve operating results that will allow us to make distributions at a specific level or at all. In addition, due to the asset coverage test applicable to us as a business development company, we may be precluded from making distributions. Also, certain of our credit facilities limit our ability to declare dividends if we default under certain provisions. As of June 30, 2009 we had an asset coverage of 174%. Therefore, we may be precluded from declaring dividends or other distributions to our shareholders unless our asset coverage is at least 200%.

If we do not meet the distribution requirements for regulated investment companies, we will suffer adverse tax consequences. In addition, in accordance with U.S. generally accepted accounting principles and tax regulations, we include in income certain amounts that we have not yet received in cash, such as contractual payment-in-kind interest, which represents contractual interest added to the loan balance that becomes due at the end of the loan term, or the accrual of original issue discount. The increases in loan balances as a result of contractual payment-in-kind arrangements are included in income in advance of receiving cash payment and are separately included in payment-in-kind interest and dividends, net of cash collections in our consolidated statement of cash flows. Since we may recognize income before or without receiving cash representing such income, we may have difficulty meeting the requirement to distribute at least 90% of our investment company taxable income to obtain tax benefits as a regulated investment company.

### **Risks Related to Changes in Interest Rates**

**Changes in interest rates may affect our cost of capital and net investment income.** Because we borrow money to make investments, our net investment income is dependent upon the difference between the rate at which we borrow funds and the rate at which we invest these funds. As a result, there can be no assurance that a significant change in market interest rates will not have a material adverse effect on our net investment income. In periods of rising interest rates, our cost of funds would increase, which would reduce our net investment income. In addition, defaults under our borrowing arrangements may result in higher interest costs during the continuance of an event of default. In July 2009, we agreed in principle to terms with the lenders under our revolving line of credit and the holders of our private notes on a comprehensive restructuring of these debt agreements. We expect the restructured debt to result in a significantly increased cost of capital. As a result, we expect our profitability will be substantially reduced. We may use interest rate risk management techniques in an effort to limit our exposure to interest rate fluctuations. Such techniques may include various interest rate hedging activities to the extent permitted by the 1940 Act.

### **Risks Related to Asset Management Activities**



**There are potential conflicts of interest between us and the funds managed by us.** Certain of our officers serve or may serve in an investment management capacity to funds managed by us. As a result, investment professionals may allocate such time and attention as is deemed appropriate and necessary to carry out the

operations of the managed funds. In this respect, they may experience diversions of their attention from us and potential conflicts of interest between their work for us and their work for the managed funds in the event that the interests of the managed funds run counter to our interests.

Although managed funds may have a different primary investment objective than we do, the managed funds may, from time to time, invest in the same or similar asset classes that we target. In addition, more than one fund managed by us may invest in the same or similar asset classes. These investments may be made at the direction of the same individuals acting in their capacity on behalf of us and one or more of the managed funds. As a result, there may be conflicts in the allocation of investment opportunities between us and the managed funds or among the managed funds. We may or may not participate in investments made by investment funds managed by us or one of our affiliates. See Management's Discussion and Analysis and Results of Operations Managed Funds.

We have sold assets to certain managed funds and, as part of our investment strategy, we may offer to sell additional assets to managed funds or we may purchase assets from managed funds. In addition, funds managed by us may offer assets to or may purchase assets from one another. While assets may be sold or purchased at prices that are consistent with those that could be obtained from third parties in the marketplace, there is an inherent conflict of interest in such transactions between us and funds we manage.

**Our financial results could be negatively affected if our Managed Funds fail to perform as expected.** In the event that any of our Managed Funds were to perform below our expectations, our financial results could be negatively affected as a result of a reduction in management fees, the deferral in payment of management fees or a reduction in incentive fees we earn. Also, if the Managed Funds perform below expectations, investors could demand lower fees or fee concessions which could also cause a decline in our income. In addition, certain of our Managed Funds are required to meet various compliance and maintenance tests related to, among other things, the ratings on fund assets and the ratio of collateral to a fund's outstanding debt. If a Managed Fund fails to comply with these tests, the payment of a portion of our management fees could be deferred until a fund regains compliance with such tests.

Moreover, because we are also an investor in certain of our Managed Funds, we could experience losses on our investments.

## **Other Risks**

**Our business depends on our key personnel.** We depend on the continued services of our executive officers and other key management personnel. If we were to lose certain of these officers or other management personnel, such a loss could result in inefficiencies in our operations and lost business opportunities, which could have a negative effect on our business.

**Results may fluctuate and may not be indicative of future performance.** Our operating results may fluctuate and, therefore, you should not rely on current or historical period results to be indicative of our performance in future reporting periods. Factors that could cause operating results to fluctuate include, but are not limited to, variations in the investment origination volume and fee income earned, changes in the accrual status of our loans and debt securities, variations in timing of prepayments, variations in and the timing of the recognition of net realized gains or losses and changes in unrealized appreciation or depreciation, the level of our expenses, the degree to which we encounter competition in our markets, and general economic conditions.

**Our common stock price may be volatile.** The trading price of our common stock may fluctuate substantially. The capital and credit markets have been experiencing extreme volatility and disruption for more than 12 months, reaching unprecedented levels. We have experienced significant stock price volatility. In general, the price of the common stock may be higher or lower than the price paid by stockholders, depending on many factors,



some of which are beyond our control and may not be directly related to our operating performance. These factors include, but are not limited to, the following:

price and volume fluctuations in the overall stock market from time to time;

significant volatility in the market price and trading volume of securities of business development companies or other financial services companies;

volatility resulting from trading in derivative securities related to our common stock including puts, calls, long-term equity anticipation securities, or LEAPs, or short trading positions;

the financial performance of the specific industries in which we invest on a recurring basis;

changes in laws or regulatory policies or tax guidelines with respect to business development companies or regulated investment companies;

actual or anticipated changes in our earnings or fluctuations in our operating results or changes in the expectations of securities analysts;

general economic conditions and trends;

loss of a major funding source; or

departures of key personnel.

**The trading market or market value of our publicly issued debt securities may be volatile.** Our publicly issued debt securities may or may not have an established trading market. We cannot assure that a trading market for our publicly issued debt securities will ever develop or be maintained if developed. In addition to our creditworthiness, many factors may materially adversely affect the trading market for, and market value of, our publicly issued debt securities. These factors include, but are not limited to, the following:

the time remaining to the maturity of these debt securities;

the outstanding principal amount of debt securities with terms identical to these debt securities;

the ratings assigned by national statistical ratings agencies;

the general economic environment;

the supply of debt securities trading in the secondary market, if any;

the redemption or repayment features, if any, of these debt securities;

the level, direction and volatility of market interest rates generally; and

market rates of interest higher or lower than rates borne by the debt securities.

There also may be a limited number of buyers for our debt securities. This too may materially adversely affect the market value of the debt securities or the trading market for the debt securities.

**Our common stock could be delisted from the New York Stock Exchange if we trade below \$1.00 or if we fail to meet other listing criteria.** In order to maintain our listing on the New York Stock Exchange (NYSE), we must continue to meet the NYSE minimum share price listing rule, the minimum market capitalization rule and other continued listing criteria. Under the NYSE continued listing criteria, the average closing price of our common stock must not be below \$1.00 per share for 30 or more consecutive trading days. In the event that the average closing price of our common stock is below \$1.00 per share over a consecutive 30-day trading period, we would have a six-month cure period to attain both a \$1.00 share price and a \$1.00 average share price over 30 trading days.

If our common stock were delisted, it could (i) reduce the liquidity and market price of our common stock; (ii) negatively impact our ability to raise equity financing and access the public capital markets; and (iii) materially adversely impact our results of operations and financial condition.

**Item 2. *Unregistered Sales of Equity Securities and Use of Proceeds***

No unregistered sales of equity securities occurred during the three months ended June 30, 2009 and 2008.

**Issuer Purchases of Equity Securities**

We did not purchase shares of our equity securities during the three months ended June 30, 2009. During the three months ended June 30, 2008, we purchased a total of 262,716 shares by a plan agent for shareholders pursuant to our dividend reinvestment plan at an aggregate cost of \$3.7 million.

During the three months ended June 30, 2009, we purchased publicly issued notes in the market with a total par value of \$77.6 million original principal amount of our 6.625% Notes due 2011 for \$29.6 million and \$54.4 million of our 6.000% Notes due 2012, for \$20.2 million.

**Item 3. *Defaults Upon Senior Securities***

None.

**Item 4. *Submission of Matters to a Vote of Security Holders***

Our 2009 Annual Meeting of Stockholders of the Company ( Meeting ) was held in Washington, DC on May 13, 2009. Shareholders voted on the election of four directors of the Company, who will serve for three years and the ratification of the selection of KPMG LLP to serve as the independent registered public accounting firm for the Company for the year ending December 31, 2009. The results of the voting of each such matter are described below. There were no broker non-votes for items 1 and 2 below.

1. Election of Directors: Shareholders elected five directors of the Company, who will serve for three years, or until their successors are elected and qualified. This item was approved. Votes were cast as follows:

	<b>For</b>	<b>Withheld</b>
Ann Torre Bates	151,075,194	10,345,534
Edward J. Mathias	151,671,663	9,749,065
Alex J. Pollock	151,727,150	9,693,578
John M. Scheurer	151,958,000	9,462,728

The following directors are continuing as directors of the Company for their respective terms William L. Walton, Joan M. Sweeney, Brooks H. Browne, Robert E. Long, John D. Firestone, Anthony T. Garcia, Lawrence I. Hebert, Marc F. Racicot, and Laura W. van Roijen.

2. Ratification of the selection of KPMG LLP to serve as independent registered public accounting firm for the year ending December 31, 2009. This item was approved. Votes were cast as follows:

<b>For</b>	<b>Against</b>	<b>Abstain</b>
156,068,866	3,937,981	1,413,881

**Item 5. *Other Information***

None.

**Item 6. Exhibits**

## (a) List of Exhibits

<b>Exhibit Number</b>	<b>Description</b>
3.1	Restated Articles of Incorporation. <i>(Incorporated by reference to Exhibit a.2 filed with Allied Capital's Post-Effective Amendment No. 1 to registration statement on Form N-2 (File No. 333-141847) filed on June 1, 2007).</i>
3.2	Amended and Restated Bylaws. <i>(Incorporated by reference to Exhibit 3.2 filed with Allied Capital's Form 10-K on March 2, 2009).</i>
4.1	Specimen Certificate of Allied Capital's Common Stock, par value \$0.0001 per share. <i>(Incorporated by reference to Exhibit d. filed with Allied Capital's registration statement on Form N-2 (File No. 333-51899) filed on May 6, 1998).</i>
4.3	Form of Note under the Indenture relating to the issuance of debt securities. <i>(Contained in Exhibit 4.4). (Incorporated by reference to Exhibit d.1 filed with Allied Capital's registration statement on Form N-2/A (File No. 333-133755) filed on June 21, 2006).</i>
4.4	Indenture by and between Allied Capital Corporation and The Bank of New York, dated June 16, 2006. <i>(Incorporated by reference to Exhibit d.2 filed with Allied Capital's registration statement on Form N-2/A (File No. 333-133755) filed on June 21, 2006).</i>
4.5	Statement of Eligibility of Trustee on Form T-1. <i>(Incorporated by reference to Exhibit d.3 filed with Allied Capital's registration statement on Form N-2 (File No. 333-133755) filed on May 3, 2006).</i>
4.6	Form of First Supplemental Indenture by and between Allied Capital Corporation and the Bank of New York, dated as of July 25, 2006. <i>(Incorporated by reference to Exhibit d.4 filed with Allied Capital's Post-Effective Amendment No. 1 to the registration statement on Form N-2/A (File No. 333-133755) filed on July 25, 2006).</i>
4.7	Form of 6.625% Note due 2011. <i>(Incorporated by reference to Exhibit d.5 filed with Allied Capital's Post-Effective Amendment No. 1 to the registration statement on Form N-2/A (File No. 333-133755) filed on July 25, 2006).</i>
4.8	Form of Second Supplemental Indenture by and between Allied Capital Corporation and The Bank of New York, dated as of December 8, 2006. <i>(Incorporated by reference to Exhibit d.6 filed with Allied Capital's Post-Effective Amendment No. 2 to the registration statement on Form N-2/A (File No. 333-133755) filed on December 8, 2006).</i>
4.9	Form of 6.000% Notes due 2012. <i>(Incorporated by reference to Exhibit d.7 filed with Allied Capital's Post-Effective Amendment No. 2 to the registration statement on Form N-2/A (File No. 333-133755) filed on December 8, 2006).</i>
4.10	Form of Third Supplemental Indenture by and between Allied Capital Corporation and The Bank of New York, dated as of March 28, 2007. <i>(Incorporated by reference to Exhibit d.8 filed with Allied Capital's Post-Effective Amendment No. 3 to the registration statement on Form N-2/A (File No. 333-133755) filed on March 28, 2007).</i>
4.11	Form of 6.875% Notes due 2047. <i>(Incorporated by reference to Exhibit d.9 filed with Allied Capital's Post-Effective Amendment No. 3 to the registration statement on Form N-2/A (File No. 333-133755) filed on March 28, 2007).</i>
4.11(a)	Form of 6.875% Notes due 2047. <i>(Incorporated by reference to Exhibit d.9(a) filed with Allied Capital's Post-Effective Amendment No. 4 to the registration statement on Form N-2/A (File No. 333-133755) filed</i>



- on April 2, 2007).*
- 10.1 Dividend Reinvestment Plan, as amended. *(Incorporated by reference to Exhibit e. filed with Allied Capital's registration statement on Form N-2 (File No. 333-87862) filed on May 8, 2002).*
- 10.2 Credit Agreement, dated April 9, 2008. *(Incorporated by reference to Exhibit 10.1 filed with Allied Capital's Form 8-K on April 10, 2008).*
- 10.2(a) First Amendment to Credit Agreement, dated December 30, 2008. *(Incorporated by reference to Exhibit 10.2 filed with Allied Capital's Form 8-K on December 31, 2008).*
- 10.3 Note Agreement, dated October 13, 2005. *(Incorporated by reference to Exhibit 10.1 filed with Allied Capital's Form 8-K on October 14, 2005).*

Exhibit Number	Description
10.3(a)	Amendment dated February 29, 2008, to Note Agreement dated as of October 13, 2005. <i>(Incorporated by reference to Exhibit f.3(a) filed with Allied Capital's Form N-2 (File No. 333-150006) filed on April 1, 2008).</i>
10.4	Note Agreement, dated May 1, 2006. <i>(Incorporated by reference to Exhibit 10.1 filed with Allied Capital's Form 8-K on May 1, 2006).</i>
10.4(a)	Amendment dated February 29, 2008, to Note Agreement dated as of May 1, 2006. <i>(Incorporated by reference to Exhibit f.11(a) filed with Allied Capital's Form N-2 (File No. 333-150006) filed on April 1, 2008).</i>
10.15	Second Amended and Restated Control Investor Guaranty, dated as of January 30, 2008, between Allied Capital and CitiBank, N.A., as Administrative Agent. <i>(Incorporated by reference to Exhibit 10.1 filed with Allied Capital's Form 8-K filed on February 5, 2008).</i>
10.17	The 2005 Allied Capital Corporation Non-Qualified Deferred Compensation Plan II. <i>(Incorporated by reference to Exhibit 10.2 filed with Allied Capital's Form 8-K filed on December 21, 2005).</i>
10.17(a)	Amendment to The 2005 Allied Capital Corporation Non-Qualified Deferred Compensation Plan II, dated January 20, 2006. <i>(Incorporated by reference to Exhibit 10.17(a) filed with Allied Capital's Form 10-K for the year ended December 31, 2005).</i>
10.17(b)	Amendment to The 2005 Allied Capital Corporation Non-Qualified Deferred Compensation Plan II, dated December 14, 2007. <i>(Incorporated by reference to Exhibit 10.2 filed with Allied Capital's Form 8-K filed on December 19, 2007).</i>
10.18	The 2005 Allied Capital Corporation Non-Qualified Deferred Compensation Plan. <i>(Incorporated by reference to Exhibit 10.1 filed with Allied Capital's Form 8-K filed on December 21, 2005).</i>
10.18(a)	Amendment to The 2005 Allied Capital Corporation Non-Qualified Deferred Compensation Plan, dated January 20, 2006. <i>(Incorporated by reference to Exhibit 10.18(a) filed with Allied Capital's Form 10-K for the year ended December 31, 2005).</i>
10.18(b)	Amendment to The 2005 Allied Capital Corporation Non-Qualified Deferred Compensation Plan, dated December 14, 2007. <i>(Incorporated by reference to Exhibit 10.1 filed with Allied Capital's Form 8-K filed on December 19, 2007).</i>
10.19	Amended Stock Option Plan. <i>(Incorporated by reference to Appendix B of Allied Capital's definitive proxy statement for Allied Capital's 2007 Annual Meeting of Stockholders filed on April 3, 2007).</i>
10.20(a)	Allied Capital Corporation 401(k) Plan, dated September 1, 1999. <i>(Incorporated by reference to Exhibit 4.4 filed with Allied Capital's registration statement on Form S-8 (File No. 333-88681) filed on October 8, 1999).</i>
10.20(b)	Amendment to Allied Capital Corporation 401(k) Plan, dated April 15, 2004. <i>(Incorporated by reference to Exhibit 10.20(b) filed with Allied Capital's Form 10-Q for the period ended June 30, 2004).</i>
10.20(c)	Amendment to Allied Capital Corporation 401(k) plan, dated November 1, 2005. <i>(Incorporated by reference to Exhibit 10.20(c) filed with Allied Capital's Form 10-Q for the quarter ended September 30, 2005).</i>
10.20(d)	Amendment to Allied Capital Corporation 401(k) plan, dated April 21, 2006. <i>(Incorporated by reference to Exhibit i.4(c) filed with Allied Capital's Form N-2 (File No. 333-133755) filed on May 3, 2006).</i>
10.20(e)	Amendment to Allied Capital Corporation 401(k) plan, adopted December 18, 2006. <i>(Incorporated by reference to Exhibit 10.20(e) filed with Allied Capital's Form 10-K for the year ended December 31, 2006).</i>
10.20(f)	Amendment to Allied Capital Corporation 401(k) plan, dated June 21, 2007. <i>(Incorporated by reference to Exhibit 10.20(f) filed with Allied Capital's Form 10-Q for the quarter ended June 30, 2007).</i>
10.20(g)	

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- Amendment to Allied Capital Corporation 401(k) plan, dated June 21, 2007. *(Incorporated by reference to Exhibit 10.20(g) filed with Allied Capital's Form 10-Q for the quarter ended June 30, 2007).*
- 10.20(h) Amendment to Allied Capital Corporation 401(k) plan, dated September 14, 2007, with an effective date of January 1, 2008. *(Incorporated by reference to Exhibit 10.20(h) filed with Allied Capital's Form 10-Q for the quarter ended September 30, 2007).*
- 10.20(i) Amendment to Allied Capital Corporation 401(k) Plan. *(Incorporated by reference to Exhibit 10.20(i) filed with Allied Capital's Form 10-Q for the period ended March 31, 2009).*

Exhibit Number	Description
10.21	Employment Agreement, dated January 1, 2004, between Allied Capital and William L. Walton. <i>(Incorporated by reference to Exhibit 10.21 filed with Allied Capital's Form 10-K for the year ended December 31, 2003).</i>
10.21(a)	Amendment to Employment Agreement, dated March 29, 2007, between Allied Capital and William L. Walton. <i>(Incorporated by reference to Exhibit 10.1 filed with Allied Capital's Form 8-K filed on April 3, 2007).</i>
10.21(b)	Second Amendment to Employment Agreement, dated December 15, 2008, between Allied Capital and William L. Walton. <i>(Incorporated by reference to Exhibit 10.21(b) filed with Allied Capital's Form 10-K for the year ended December 31, 2008).</i>
10.21(c)	Third Amendment to Employment Agreement, dated February 26, 2009, between Allied Capital and William L. Walton. <i>(Incorporated by reference to Exhibit 10.21(c) filed with Allied Capital's Form 10-K for the year ended December 31, 2008).</i>
10.22	Employment Agreement, dated January 1, 2004, between Allied Capital and Joan M. Sweeney. <i>(Incorporated by reference to Exhibit 10.22 filed with Allied Capital's Form 10-K for the year ended December 31, 2003).</i>
10.22(a)	Amendment to Employment Agreement, dated March 29, 2007, between Allied Capital and Joan M. Sweeney. <i>(Incorporated by reference to Exhibit 10.2 filed with Allied Capital's Form 8-K filed on April 3, 2007).</i>
10.22(b)	Second Amendment to Employment Agreement, dated December 15, 2008, between Allied Capital and Joan M. Sweeney. <i>(Incorporated by reference to Exhibit 10.22(b) filed with Allied Capital's Form 10-K for the year ended December 31, 2008).</i>
10.23	Employment Agreement, dated January 1, 2004, between Allied Capital and Penelope F. Roll. <i>(Incorporated by reference to Exhibit 10.23 filed with Allied Capital's Form 10-K for the year ended December 31, 2006).</i>
10.23(a)	Amendment to Employment Agreement, dated March 29, 2007, between Allied Capital and Penelope F. Roll. <i>(Incorporated by reference to Exhibit 10.3 filed with Allied Capital's Form 8-K filed on April 3, 2007).</i>
10.23(b)	Second Amendment to Employment Agreement, dated December 15, 2008, between Allied Capital and Penelope F. Roll. <i>(Incorporated by reference to Exhibit 10.23(b) filed with Allied Capital's Form 10-K for the year ended December 31, 2008).</i>
10.23(c)	Third Amendment to Employment Agreement, dated May 5, 2009, between Allied Capital and Penelope F. Roll. <i>(Incorporated by reference to Exhibit 10.23(c) filed with Allied Capital's Form 10-Q for the period ended March 31, 2009).</i>
10.24	Employment Agreement, dated May 5, 2009, between Allied Capital and John M. Scheurer. <i>(Incorporated by reference to Exhibit 10.24 filed with Allied Capital's Form 10-Q for the period ended March 31, 2009).</i>
10.25	Form of Custody Agreement with Riggs Bank N.A., which was assumed by PNC Bank through merger. <i>(Incorporated by reference to Exhibit j.1 filed with Allied Capital's registration statement on Form N-2 (File No. 333-51899) filed on May 6, 1998).</i>
10.26	Custodian Agreement with Chevy Chase Trust. <i>(Incorporated by reference to Exhibit 10.26 filed with Allied Capital's Form 10-K for the year ended December 31, 2005).</i>
10.27	Custodian Agreement with Bank of America. <i>(Incorporated by reference to Exhibit 10.27 filed with Allied Capital's Form 10-K for the year ended December 31, 2005).</i>
10.28	Code of Ethics. <i>(Incorporated by reference to Exhibit 10.28 filed with Allied Capital's Form 10-K for the year ended December 31, 2006).</i>

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- 10.29 Custodian Agreement with Union Bank of California. *(Incorporated by reference to Exhibit 10.29 filed with Allied Capital's Form 10-Q for the quarter ended June 30, 2006).*
- 10.30 Custodian Agreement with M&T Bank. *(Incorporated by reference to Exhibit 10.30 filed with Allied Capital's Form 10-Q for the quarter ended June 30, 2006).*
- 10.31 Note Agreement, dated as of May 14, 2003. *(Incorporated by reference to Exhibit 10.31 filed with Allied Capital's Form 10-Q for the quarter ended March 31, 2003).*

Exhibit Number	Description
10.31(a)	Amendment dated February 29, 2008, to Note Agreement dated as of May 14, 2003. <i>(Incorporated by reference to Exhibit f.19(a) filed with Allied Capital's Form N-2 (File No. 333-150006) filed on April 1, 2008).</i>
10.32	Custodian Agreement with Branch Banking and Trust Company. <i>(Incorporated by reference to Exhibit 10.32 filed with Allied Capital's Form 10-Q for the period ended March 31, 2009).</i>
10.33	Note Agreement, dated June 20, 2008. <i>(Incorporated by reference to Exhibit 10.1 filed with Allied Capital's Form 8-K on June 23, 2008).</i>
10.34	Retention Agreement dated May 13, 2009, between Allied Capital and Joan M. Sweeney. <i>(Incorporated by reference to exhibit 10.1 filed with Allied Capital's Form 8-K filed on May 19, 2009).</i>
10.37	Form of Indemnification Agreement between Allied Capital and its directors and certain officers. <i>(Incorporated by reference to Exhibit 10.37 filed with Allied Capital's Form 10-K for the year ended December 31, 2003).</i>
10.38	Note Agreement, dated as of March 25, 2004. <i>(Incorporated by reference to Exhibit 10.38 filed with Allied Capital's Form 10-Q for the period ended March 31, 2004.)</i>
10.38(a)	Amendment dated February 29, 2008, to Note Agreement dated as of March 25, 2004. <i>(Incorporated by reference to Exhibit f.25(a) filed with Allied Capital's Form N-2 (File No. 333-150006) filed on April 1, 2008).</i>
10.38(b)	First Waiver and Second Amendment dated as of July 25, 2008, to the Note Agreement dated as of March 25, 2004. <i>(Incorporated by reference to Exhibit 10.38(b) filed with Allied Capital's Form 10-Q for the period ended June 30, 2008).</i>
10.39	Note Agreement, dated as of November 15, 2004. <i>(Incorporated by reference to Exhibit 99.1 filed with Allied Capital's current report on Form 8-K filed on November 18, 2004.)</i>
10.39(a)	Amendment dated February 29, 2008, to Note Agreement dated as of November 15, 2004. <i>(Incorporated by reference to Exhibit f.26(a) filed with Allied Capital's Form N-2 (File No. 333-150006) filed on April 1, 2008).</i>
10.40	Real Estate Securities Purchase Agreement. <i>(Incorporated by reference to Exhibit 2.1 filed with Allied Capital's Form 8-K filed on May 4, 2005.)</i>
10.41	Platform Assets Purchase Agreement. <i>(Incorporated by reference to Exhibit 2.2 filed with Allied Capital's Form 8-K filed on May 4, 2005.)</i>
10.42	Transition Services Agreement. <i>(Incorporated by reference to Exhibit 10.1 filed with Allied Capital's Form 8-K filed on May 4, 2005.)</i>
10.43	First Omnibus Waiver and Amendment to the Note Agreements, dated as of July 25, 2008. <i>(Incorporated by reference to Exhibit 10.40 filed with Allied Capital's Form 10-Q for the period ended June 30, 2008).</i>
10.43(a)	Second Omnibus Amendment to the Note Agreements, dated as of December 30, 2008. <i>(Incorporated by reference to Exhibit 10.1 filed with Allied Capital's Form 8-K December 31, 2008).</i>
10.44	Custodian Agreement, dated as of April 3, 2009 by and between Allied Capital Corporation and U.S. Bank National Association. <i>(Incorporated by reference to Exhibit 10.44 filed with Allied Capital's Form 10-Q for the period ended March 31, 2009).</i>
11	Statement regarding computation of per share earnings is included in Note 7 to Allied Capital's Notes to the Consolidated Financial Statements.
15*	Letter regarding unaudited interim financial information.

Exhibit Number	Description
21	Subsidiaries of Allied Capital and jurisdiction of incorporation/organization: A.C. Corporation Delaware Allied Capital REIT, Inc. Maryland Allied Capital Holdings, LLC Delaware Allied Capital Beteiligungsberatung GmbH (inactive) Germany
31.1*	Certification of the Chairman of the Board pursuant to Rule 13a-14 of the Securities Exchange Act of 1934.
31.2*	Certification of the Chief Executive Officer pursuant to Rule 13a-14 of the Securities Exchange Act of 1934.
31.3*	Certification of the Chief Financial Officer pursuant to Rule 13a-14 of the Securities Exchange Act of 1934.
31.4*	Certification of the Chief Accounting Officer pursuant to Rule 13a-14 of the Securities Exchange Act of 1934.
32.1*	Certification of the Chairman of the Board pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350.
32.2*	Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350.
32.3*	Certification of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350.
32.4*	Certification of the Chief Accounting Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350.

\* Filed herewith.

**SIGNATURES**

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

ALLIED CAPITAL CORPORATION  
(Registrant)

Dated: August 10, 2009

/s/ William L. Walton

William L. Walton  
Chairman of the Board

/s/ John M. Scheurer

John M. Scheurer  
Chief Executive Officer and President

/s/ Penni F. Roll

Penni F. Roll  
Chief Financial Officer

/s/ John C. Wellons

John C. Wellons  
Chief Accounting Officer



**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Description</b>
15	Letter regarding Unaudited Interim Financial Information.
31.1	Certification of the Chairman of the Board pursuant to Rule 13a-14 of the Securities Exchange Act of 1934.
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