ALLIED CAPITAL CORP
Form 10-Q
November 06, 2009

FORM 10-Q

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

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

For The Quarterly Period
Ended September 30, 2009

o **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	**52-1081052**
(State or Jurisdiction of Incorporation of Organization)	*(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 x NO o

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 o NO o

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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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

(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 o NO x

On November 5, 2009, there were 179,400,109 shares outstanding of the Registrant s common stock, $0.0001 par value.

ALLIED CAPITAL CORPORATION

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PART I: FINANCIAL INFORMATION

Item 1. ***Financial Statements***

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

(in thousands, except per share amounts)	September 30, 2009 (unaudited)	December 31, 2008
ASSETS		
Portfolio at value:		
Private finance		
Companies more than 25% owned (cost: 2009-$2,025,850; 2008-$2,167,020)	$ 1,032,018	$ 1,187,722
Companies 5% to 25% owned (cost: 2009-$219,671; 2008-$392,516)	178,253	352,760
Companies less than 5% owned (cost: 2009-$1,948,748; 2008-$2,317,856)	1,232,400	1,858,581
Total private finance (cost: 2009-$4,194,269; 2008-$4,877,392)	2,442,671	3,399,063
Commercial real estate finance (cost: 2009-$74,066; 2008-$85,503)	68,523	93,887
Total portfolio at value (cost: 2009-$4,268,335; 2008-4,962,895)	2,511,194	3,492,950
Accrued interest and dividends receivable	49,953	55,638
Other assets	125,653	122,909
Investments in money market and other securities	90,020	287
Cash and cash equivalents	62,737	50,402
Restricted cash	659	
Total assets	$ 2,840,216	$ 3,722,186
LIABILITIES AND SHAREHOLDERS EQUITY		
Liabilities:		
Notes payable (principal amount: 2009-$1,586,513; 2008-$1,895,000) (maturing within one year: 2009-$253,745; 2008-$1,015,000)	$ 1,543,867	$ 1,895,000
Bank term debt (former revolver)	50,000	50,000
Accounts payable and other liabilities	45,084	58,786
Total liabilities	1,638,951	2,003,786
Commitments and contingencies		
Shareholders equity:		
Common stock, $0.0001 par value, 400,000 shares authorized; 179,362 and 178,692 shares issued and outstanding at September 30, 2009, and December 31, 2008, respectively	18	18
Additional paid-in capital	3,037,718	3,037,845

Notes receivable from sale of common stock	(680)	(1,089)
Net unrealized appreciation (depreciation)	(1,883,617)	(1,503,089)
Undistributed earnings	47,826	184,715
Total shareholders equity	1,201,265	1,718,400
Total liabilities and shareholders equity	$ 2,840,216	$ 3,722,186
Net asset value per common share	$ 6.70	$ 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 September 30, 2009	For the Three Months Ended September 30, 2008	For the Nine Months Ended September 30, 2009	For the Nine Months Ended September 30, 2008
	(unaudited)		(unaudited)	
Interest and Related Portfolio Income:				
Interest and dividends:				
Companies more than 25% owned	$ 24,737	$ 29,699	$ 72,941	$ 85,167
Companies 5% to 25% owned	4,775	9,864	25,123	31,587
Companies less than 5% owned	36,118	72,644	131,953	249,325
Total interest and dividends	65,630	112,207	230,017	366,079
Fees and other income:				
Companies more than 25% owned	6,063	6,130	18,648	22,638
Companies 5% to 25% owned	13	342	223	411
Companies less than 5% owned	732	1,983	3,362	11,056
Total fees and other income	6,808	8,455	22,233	34,105
Total interest and related portfolio income	72,438	120,662	252,250	400,184
Expenses:				
Interest	42,421	35,949	129,023	109,974
Employee	10,905	21,443	32,939	57,439
Employee stock options	392	1,477	2,369	9,531
Administrative	7,205	14,138	25,509	36,100
Impairment of long-lived asset			2,873	
Total operating expenses	60,923	73,007	192,713	213,044
Net investment income before income taxes	11,515	47,655	59,537	187,140
Income tax expense (benefit), including excise tax	1,930	2,060	4,205	8,141
Net investment income	9,585	45,595	55,332	178,999
Net Realized and Unrealized Gains (Losses):				
Net realized gains (losses):				
Companies more than 25% owned	(12,681)	1,098	(89,643)	1,967
Companies 5% to 25% owned	(824)	7,234	(54,963)	(6,569)
Companies less than 5% owned	8,415	53,710	(13,649)	51,932

Total net realized gains (losses)		(5,090)		62,042		(158,255)		47,330
Net change in unrealized appreciation or depreciation		(27,681)		(425,899)		(380,528)		(687,506)
Total net gains (losses)		(32,771)		(363,857)		(538,783)		(640,176)
Gain on repurchase of debt						83,532		
Loss on extinguishment of debt		(117,497)				(117,497)		
Net increase (decrease) in net assets resulting from operations	$	(140,683)	$	(318,262)	$	(517,416)	$	(461,177)
Basic earnings (loss) per common share	$	(0.79)	$	(1.78)	$	(2.89)	$	(2.70)
Diluted earnings (loss) per common share	$	(0.79)	$	(1.78)	$	(2.89)	$	(2.70)
Weighted average common shares outstanding basic		179,054		178,692		178,815		171,084
Weighted average common shares outstanding diluted		179,054		178,692		178,815		171,084

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN NET ASSETS

(in thousands, except per share amounts)	For the Nine Months Ended September 30, 2009	2008
	(unaudited)	
Operations:		
Net investment income	$ 55,332	$ 178,999
Net realized gains (losses)	(158,255)	47,330
Net change in unrealized appreciation (depreciation)	(380,528)	(687,506)
Gain on repurchase of debt	83,532	
Loss on extinguishment of debt	(117,497)	
Net increase (decrease) in net assets resulting from operations	(517,416)	(461,177)
Shareholder distributions:		
Common stock dividends		(340,381)
Net decrease in net assets resulting from shareholder distributions		(340,381)
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	489	
Stock option expense	2,438	9,655
Net decrease in notes receivable from sale of common stock	409	841
Purchase of common stock held in deferred compensation trusts		(943)
Distribution of common stock held in deferred compensation trusts		27,335
Cancellation of stock options	(3,055)	
Net increase (decrease) in net assets resulting from capital share transactions	280	443,117
Total increase (decrease) in net assets	(517,135)	(358,441)
Net assets at beginning of period	1,718,400	2,771,847
Net assets at end of period	$ 1,201,265	$ 2,413,406
Net asset value per common share	$ 6.70	$ 13.51
Common shares outstanding at end of period	179,362	178,692

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ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS

(in thousands)	For the Nine Months Ended September 30, 2009	2008
	(unaudited)	
Cash flows from operating activities:		
Net increase (decrease) in net assets resulting from operations	$ (517,416)	$ (461,177)
Adjustments:		
Portfolio investments	(118,095)	(1,019,750)
Principal collections related to investment repayments or sales	479,815	878,229
Collections of notes and other consideration received from sale of investments	171,030	16,316
Realized gains from the receipt of notes and other consideration from sale of investments	(577)	(1,886)
Realized losses	194,152	87,867
Gain on repurchase of debt	(83,532)	
Redemption of (investments in) money market and other securities	(89,733)	187,838
Payment-in-kind interest and dividends, net of cash collections	(24,352)	(35,947)
Change in accrued interest and dividends	4,577	835
Net collection (amortization) of discounts and fees	(4,875)	(10,176)
Stock option expense	2,438	9,655
Impairment of long-lived asset	2,873	
Changes in other assets and liabilities	(95,823)	(42,537)
Depreciation and amortization	1,169	1,752
Net change in unrealized (appreciation) or depreciation	380,528	687,506
Net cash provided by (used in) operating activities	302,179	298,525
Cash flows from financing activities:		
Sale of common stock		402,478
Sale of common stock upon the exercise of stock options	489	
Collections of notes receivable from sale of common stock	408	841
Borrowings under notes payable		193,000
Repurchase or repayment of notes payable	(224,357)	(153,000)
Net borrowings under (repayments on) revolver/bank term debt		(197,250)
Purchase of common stock held in deferred compensation trusts		(943)
Net change in restricted cash	(659)	
Deferred financing costs	(65,725)	(8,611)
Other financing activities		(35)
Common stock dividends and distributions paid		(336,630)
Net cash provided by (used in) financing activities	(289,844)	(100,150)
Net increase (decrease) in cash	12,335	198,375

Cash at beginning of period	50,402	3,540
Cash at end of period	$ 62,737	$ 201,915

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF INVESTMENTS

Private Finance Portfolio Company (in thousands, except number of shares)	**Investment[1][2]**	**September 30, 2009 (unaudited) Principal**	**Cost**	**Value**
Companies More Than 25% Owned				
AGILE Fund I, LLC[5]	Equity Interests		$ 665	$ 417
(Private Equity Fund)	**Total Investment**		**665**	**417**
AllBridge Financial, LLC	Senior Loan (6.6%, Due 12/09)	$ 1,311	1,311	1,311
(Asset Management)	Equity Interests		40,118	15,523
	Total Investment		**41,429**	**16,834**
Allied Capital Senior Debt Fund, L.P.[5]	Limited Partnership Interests		31,800	33,044
(Private Debt Fund)	**Total Investment**		**31,800**	**33,044**
Avborne, Inc.[7]	Preferred Stock (12,500 shares)			904
(Business Services)	Common Stock (27,500 shares)			
	Total Investment			**904**
Avborne Heavy Maintenance, Inc.[7]	Common Stock (2,750 shares)			
(Business Services)	**Total Investment**			
Aviation Properties Corporation	Common Stock (100 shares)		93	
(Business Services)	**Total Investment**		**93**	
Border Foods, Inc.	Senior Loan (12.9%, Due 3/12)	34,876	29,495	34,876
(Consumer Products)	Preferred Stock (100,000 shares)		12,721	16,585
	Common Stock (260,467 shares)		3,847	
	Total Investment		**46,063**	**51,461**

Calder Capital Partners, LLC[5]	Senior Loan (12.5%, Due 5/09)[6]	4,496	4,496	1,100
(Asset Management)	Equity Interests		2,453	
	Total Investment		**6,949**	**1,100**
Callidus Capital Corporation	Subordinated Debt (18.0%, Due 8/13)	20,939	20,939	15,165
(Asset Management)	Common Stock (100 shares)			
	Total Investment		**20,939**	**15,165**
	Guaranty ($3,189)			

(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[1][2]**	**September 30, 2009 (unaudited) Principal**	**Cost**	**Value**
Ciena Capital LLC	Senior Loan (5.5%, Due 3/09)[6]	$ 319,031	$ 319,031	$ 102,232
(Financial Services)	Class B Equity Interests		119,436	
	Class C Equity Interests		109,097	
	Total Investment		**547,564**	**102,232**
	Guaranty ($5,000 See Note 3)			
CitiPostal Inc.	Senior Loan (3.7%, Due 12/13)	692	683	683
(Business Services)	Unitranche Debt (12.0%, Due 12/13)	51,180	51,001	51,001
	Subordinated Debt (16.0%, Due 12/15)	10,265	10,265	10,265
	Common Stock (37,024 shares)		12,726	1,124
	Total Investment		**74,675**	**63,073**
Coverall North America, Inc.	Unitranche Debt (12.0%, Due 7/11)	31,627	31,565	31,565
(Business Services)	Subordinated Debt (15.0%, Due 7/11)	5,563	5,553	5,553
	Common Stock (763,333 shares)		14,362	21,261
	Total Investment		**51,480**	**58,379**
CR Holding, Inc.	Subordinated Debt (16.6%, Due 2/13)[6]	40,623	40,510	10,271
(Consumer Products)	Common Stock (32,090,696 shares)		28,744	
	Total Investment		**69,254**	**10,271**

Crescent Equity Corp.[8]	Senior Loan (10.0%, Due 6/10)	433	433	433
(Business Services)	Subordinated Debt (11.0%, Due 9/11 6/17)[6]	32,202	32,112	4,203
	Common Stock (174 shares)		82,730	
	Total Investment		**115,275**	**4,636**
	Guaranty ($900)			
Direct Capital Corporation	Senior Loan (8.0%, Due 1/14)[6]	8,175	8,175	8,573
(Financial Services)	Subordinated Debt (16.0%, Due 3/13)[6]	55,671	55,496	7,139
	Common Stock (2,317,020 shares)		25,732	
	Total Investment		**89,403**	**15,712**
Financial Pacific Company	Subordinated Debt (17.4%, Due 2/12 8/12)	68,967	68,870	41,417
(Financial Services)	Preferred Stock (9,458 shares)		8,865	
	Common Stock (12,711 shares)		12,783	
	Total Investment		**90,518**	**41,417**

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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.

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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[1][2]**	**September 30, 2009 (unaudited) Principal**	**Cost**	**Value**
Hot Light Brands, Inc.	Senior Loan (9.0%, Due 2/11)[6]	$ 30,572	$ 30,572	$ 10,471
(Retail)	Common Stock (93,500 shares)		5,151	
	Total Investment		**35,723**	**10,471**
Hot Stuff Foods, LLC	Senior Loan (3.7%, Due 2/11-2/12)	45,417	45,310	45,417
(Consumer Products)	Subordinated Debt (12.3%, Due 8/12-2/13)[6]	83,692	83,387	49,801
	Common Stock (1,147,453 shares)		56,187	
	Total Investment		**184,884**	**95,218**
Huddle House, Inc.	Subordinated Debt (15.0%, Due 12/15)	19,544	19,494	19,494
(Retail)	Common Stock (358,428 shares)		36,348	7,651
	Total Investment		**55,842**	**27,145**
IAT Equity, LLC and Affiliates	Subordinated Debt (9.0%, Due 6/14)	6,000	6,000	6,000
d/b/a Industrial Air Tool	Equity Interests		7,500	9,948
(Industrial Products)	**Total Investment**		**13,500**	**15,948**
Impact Innovations Group, LLC	Equity Interests in Affiliate			322
(Business Services)	**Total Investment**			**322**
Insight Pharmaceuticals Corporation	Subordinated Debt (15.0%, Due 9/12)	54,167	54,100	52,098
(Consumer Products)	Common Stock (155,000 shares)		40,413	10,419

	Total Investment		**94,513**	**62,517**
Jakel, Inc.	Subordinated Debt (15.5%, Due 3/08)[6]	748	748	374
(Industrial Products)	**Total Investment**		**748**	**374**
Knightsbridge CLO 2007-1 Ltd.[4] (CLO)	Class E Notes (9.5%, Due 1/22)	18,700	18,700	11,160
	Income Notes (13.3%)[11]		38,746	22,640
	Total Investment		**57,446**	**33,800**
Knightsbridge CLO 2008-1 Ltd.[4] (CLO)	Class C Notes (7.8%, Due 6/18)	12,800	12,800	12,246
	Class D Notes (8.8%, Due 6/18)	8,000	8,000	7,080
	Class E Notes (5.3%, Due 6/18)	13,200	11,081	9,798
	Income Notes (21.2%)[11]		21,327	20,112
	Total Investment		**53,208**	**49,236**

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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)	**Investment[1][2]**	**Principal**	**September 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	41,402	36,021
	Subordinated Debt (8.0%, Due 7/12)[6]	144	139	
	Common Stock (560,716 shares)		555	
	Total Investment		**67,352**	**61,277**
Penn Detroit Diesel Allison, LLC	Equity Interests		20,081	13,870
(Business Services)	**Total Investment**		**20,081**	**13,870**
Senior Secured Loan Fund LLC	Subordinated Certificates (8.4%)		165,248	165,000
(Private Debt Fund)	Equity Interests		1	
	Total Investment		**165,249**	**165,000**
Service Champ, Inc.	Subordinated Debt (15.5%, Due 4/12)	27,566	27,515	27,515
(Business Services)	Common Stock (55,112 shares)		11,785	28,321
	Total Investment		**39,300**	**55,836**
Stag-Parkway, Inc.	Subordinated Debt (10.0%, Due 7/12)	19,044	19,000	19,000
(Business Services)	Common Stock (25,000 shares)		32,686	7,359
	Total Investment		**51,686**	**26,359**

Startec Equity, LLC	Equity Interests		211	
(Telecommunications)	**Total Investment**		**211**	
Total companies more than 25% owned			**$ 2,025,850**	**$ 1,032,018**
Companies 5% to 25% Owned				
10th Street, LLC	Subordinated Debt (13.0%, Due 11/14)	$ 22,100	$ 22,004	$ 22,100
(Business Services)	Equity Interests		422	485
	Option		25	25
	Total Investment		**22,451**	**22,610**
Air Medical Group Holdings LLC	Senior Loan (4.3%, Due 3/11)	4,665	4,642	4,456
(Healthcare Services)	Equity Interests		2,993	20,000
	Total Investment		**7,635**	**24,456**
BB&T Capital Partners/Windsor Mezzanine Fund, LLC[(5)]	Equity Interests		11,789	10,009
(Private Equity Fund)	**Total Investment**		**11,789**	**10,009**

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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(1)(2)**	**September 30, 2009 (unaudited) Principal**	**Cost**	**Value**
Driven Brands, Inc.	Subordinated Debt (16.6%, Due 7/15)	$ 89,838	$ 89,477	$ 86,398
(Consumer Services)	Common Stock (3,772,098 shares)		9,516	2,500
	Total Investment		**98,993**	**88,898**
Multi-Ad Services, Inc.	Unitranche Debt (11.3%, Due 11/11)	2,508	2,491	2,488
(Business Services)	Equity Interests		1,737	1,206
	Total Investment		**4,228**	**3,694**
Pendum Acquisition, Inc.	Common Stock (8,872 shares)			
(Business Services)	**Total Investment**			
Postle Aluminum Company, LLC	Senior Loan (6.0%, Due 10/12)(6)	35,000	34,876	15,308
(Industrial Products)	Subordinated Debt (3.0%, Due 10/12)(6)	23,953	23,868	
	Equity Interests		2,174	
	Total Investment		**60,918**	**15,308**
Progressive International Corporation	Preferred Stock (500 shares)		500	5,847
	Common Stock (197 shares)		13	153
(Consumer Products)	Warrants			
	Total Investment		**513**	**6,000**
Regency Healthcare Group, LLC	Equity Interests		1,302	1,841
(Healthcare Services)	**Total Investment**		**1,302**	**1,841**

SGT India Private Limited[4]	Common Stock (150,596 shares)		4,158	
(Business Services)	**Total Investment**		**4,158**	
Soteria Imaging Services, LLC	Subordinated Debt (11.3%, Due 11/10)	4,250	4,204	4,154
(Healthcare Services)	Equity Interests		1,881	1,283
	Total Investment		**6,085**	**5,437**
Universal Environmental Services, LLC	Equity Interests		1,599	
(Business Services)	**Total Investment**		**1,599**	
Total companies 5% to 25% owned			**$ 219,671**	**$ 178,253**
Companies Less Than 5% Owned				
3SI Security Systems, Inc.	Subordinated Debt (16.6%, Due 8/13)[6]	$ 29,548	$ 29,473	$ 14,865
(Consumer Products)	**Total Investment**		**29,473**	**14,865**
Augusta Sportswear Group, Inc.	Common Stock (2,500 shares)		2,500	1,523
(Consumer Products)	**Total Investment**		**2,500**	**1,523**

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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[1][2]**	**September 30, 2009 (unaudited) Principal**	**Cost**	**Value**
Axium Healthcare Pharmacy, Inc.	Subordinated Debt (8.0%, Due 3/15)	$ 2,975	$ 2,975	$ 2,380
(Healthcare Services)	**Total Investment**		**2,975**	**2,380**
BenefitMall Holdings Inc.	Subordinated Debt (18.0%, Due 6/14)	40,326	40,250	40,250
(Business Services)	Common Stock (39,274,290 shares)[12]		39,274	73,729
	Warrants[12]			
	Total Investment		**79,524**	**113,979**
Broadcast Electronics, Inc.	Senior Loan (8.8%, Due 11/11)[6]	4,875	4,847	340
(Business Services)	Preferred Stock (2,044 shares)			
	Total Investment		**4,847**	**340**
Bushnell, Inc.	Subordinated Debt (6.8%, Due 2/14)	41,325	40,161	30,204
(Consumer Products)	**Total Investment**		**40,161**	**30,204**
Callidus Debt Partners CDO Fund I, Ltd.[4][10]	Class C Notes (12.9%, Due 12/13)[6]	19,420	19,527	2,935
(CDO)	Class D Notes (17.0%, Due 12/13)[6]	9,400	9,454	
	Total Investment		**28,981**	**2,935**
Callidus Debt Partners CLO Fund III, Ltd.[4][10]	Preferred Shares (23,600,000 shares)		20,138	2,199
(CLO)	**Total Investment**		**20,138**	**2,199**

Callidus Debt Partners CLO Fund IV, Ltd.(4)(10)	Class D Notes (5.1%, Due 4/20)	3,000	2,160	1,653
(CLO)	Income Notes (0.0%)(11)		14,868	4,366
	Total Investment		**17,028**	**6,019**
Callidus Debt Partners CLO Fund V, Ltd.(4)(10)	Income Notes (2.6%)(11)		13,521	4,625
(CLO)	**Total Investment**		**13,521**	**4,625**
Callidus Debt Partners CLO Fund VI, Ltd.(4)(10)	Class D Notes (6.5%, Due 10/21)	9,325	7,602	3,833
(CLO)	Income Notes (0.0%)(11)		29,144	4,155
	Total Investment		**36,746**	**7,988**
Callidus Debt Partners CLO Fund VII, Ltd.(4)(10)	Income Notes (0.0%)(11)		24,824	5,431
(CLO)	**Total Investment**		**24,824**	**5,431**

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(5) Non-registered investment company.

(6) Loan or debt security is on non-accrual status and therefore is considered non-income producing.

(10) The fund is managed by Callidus Capital, a portfolio company of Allied Capital.

(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.

(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.

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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[1][2]**	**September 30, 2009 (unaudited) Principal**	**Cost**	**Value**
Callidus MAPS CLO Fund I LLC[10]	Class E Notes (5.8%, Due 12/17)	$ 17,000	$ 17,000	$ 11,400
(CLO)	Income Notes (0.0%)[11]		41,176	13,662
	Total Investment		**58,176**	**25,062**
Callidus MAPS CLO Fund II, Ltd.[4][10]	Class D Notes (4.8%, Due 7/22)	7,700	3,785	3,068
(CLO)	Income Notes (0.9%)[11]		18,109	4,819
	Total Investment		**21,894**	**7,887**
Carlisle Wide Plank Floors, Inc.	Unitranche Debt (12.0%, Due 6/11)	1,644	1,637	1,533
(Consumer Products)	Common Stock (345,056 Shares)		345	
	Total Investment		**1,982**	**1,533**
Catterton Partners VI, L.P.[5]	Limited Partnership Interest		3,287	1,789
(Private Equity Fund)	**Total Investment**		**3,287**	**1,789**
Commercial Credit Group, Inc.	Subordinated Debt (15.0%, Due 6/15)	22,000	21,970	21,970
(Financial Services)	Preferred Stock (64,679 shares)		15,543	6,212
	Warrants			
	Total Investment		**37,513**	**28,182**
Community Education Centers, Inc.	Subordinated Debt (19.5%, Due 11/13)	36,654	36,602	36,501
(Education Services)	**Total Investment**		**36,602**	**36,501**
Component Hardware Group, Inc.	Subordinated Debt (13.5%, Due 1/13)	18,921	18,876	16,587

(Industrial Products)	**Total Investment**		**18,876**	**16,587**
Cook Inlet Alternative Risk, LLC	Unitranche Debt (10.8%, Due 4/13)	87,600	87,286	69,000
(Business Services)	Equity Interests		552	
	Total Investment		**87,838**	**69,000**
Cortec Group Fund IV, L.P.[5]	Limited Partnership Interest		6,572	3,812
(Private Equity)	**Total Investment**		**6,572**	**3,812**

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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[1][2]**	**September 30, 2009 (unaudited) Principal**	**Cost**	**Value**
Digital VideoStream, LLC	Unitranche Debt (11.0%, Due 2/12)	$ 13,203	$ 13,155	$ 12,825
(Business Services)	Convertible Subordinated Debt (10.0%, Due 2/16)	4,894	4,883	4,883
	Total Investment		**18,038**	**17,708**
DirectBuy Holdings, Inc.	Subordinated Debt (16.0%, Due 5/13)	76,389	76,139	60,287
(Consumer Products)	Equity Interests		8,000	
	Total Investment		**84,139**	**60,287**
Distant Lands Trading Co.	Senior Loan (6.3%, Due 11/11)	6,800	6,781	6,358
(Consumer Products)	Unitranche Debt (11.0%, Due 11/11)	43,581	43,499	41,967
	Common Stock (3,451 shares)		3,451	1,147
	Total Investment		**53,731**	**49,472**
Diversified Mercury	Senior Loan (4.5%, Due 3/13)	2,814	2,803	2,525
Communications, LLC	**Total Investment**		**2,803**	**2,525**
(Business Services)				
Dryden XVIII Leveraged	Class B Notes (5.0%, Due 10/19)[6]	9,092	7,872	2,355
Loan 2007 Limited[4]	Income Notes (0.0%)[11]		23,164	2,415
(CLO)	**Total Investment**		**31,036**	**4,770**
Dynamic India Fund IV[4][5]	Equity Interests		9,350	7,982
(Private Equity Fund)	**Total Investment**		**9,350**	**7,982**

EarthColor, Inc.	Subordinated Debt (15.0%, Due 11/13)(6)	123,819	123,385	
(Business Services)	Common Stock (63,438 shares)(12)		63,438	
	Warrants(12)			
	Total Investment		**186,823**	
eCentury Capital Partners, L.P.(5)	Limited Partnership Interest		7,274	
(Private Equity Fund)	**Total Investment**		**7,274**	
eInstruction Corporation	Subordinated Debt (12.1%, Due 7/14-1/15)	36,069	35,951	32,708
(Education Services)	Common Stock (2,406 shares)		2,500	750
	Total Investment		**38,451**	**33,458**
Farley s & Sathers Candy Company, Inc.	Subordinated Debt (8.3%, Due 3/11)	2,500	2,496	2,492
(Consumer Products)	**Total Investment**		**2,496**	**2,492**

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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[1][2]**	**Principal**	**September 30, 2009 (unaudited) Cost**	**Value**
Fidus Mezzanine Capital, L.P.[5]	Limited Partnership Interest		$ 12,828	$ 7,804
(Private Equity Fund)	**Total Investment**		**12,828**	**7,804**
Freedom Financial Network, LLC	Subordinated Debt (13.5%, Due 2/14)	$ 6,000	5,953	6,000
(Financial Services)	**Total Investment**		**5,953**	**6,000**
Geotrace Technologies, Inc.	Warrants		2,027	2,300
(Energy Services)	**Total Investment**		**2,027**	**2,300**
Gilchrist & Soames, Inc.	Subordinated Debt (13.4%, Due 10/13)	25,304	25,186	23,101
(Consumer Products)	**Total Investment**		**25,186**	**23,101**
Havco Wood Products LLC	Equity Interests		910	
(Industrial Products)	**Total Investment**		**910**	
Higginbotham Insurance Agency, Inc.	Subordinated Debt (13.7%, Due 8/13 8/14)	53,305	53,129	53,129
(Business Services)	Common Stock (23,695 shares)[12]		23,695	12,355
	Warrant[12]			
	Total Investment		**76,824**	**65,484**
The Homax Group, Inc.	Senior Loan (6.3%, Due 10/12)	10,116	10,072	9,168
(Consumer Products)	Subordinated Debt (14.5%, Due 4/14)	14,159	13,619	4,945
	Preferred Stock (76 shares)		76	

	Common Stock (24 shares)		5	
	Warrants		954	
	Total Investment		**24,726**	**14,113**
Ideal Snacks Corporation	Senior Loan (8.5%, Due 6/10)	1,084	1,084	1,068
(Consumer Products)	**Total Investment**		**1,084**	**1,068**
Kodiak Fund LP(5)	Equity Interests		9,332	900
(Private Equity Fund)	**Total Investment**		**9,332**	**900**
Market Track Holdings, LLC	Senior Loan (8.0%, Due 6/14)	2,500	2,450	2,392
(Business Services)	Subordinated Debt (15.9%, Due 6/14)	24,600	24,504	23,166
	Total Investment		**26,954**	**25,558**
NetShape Technologies, Inc.	Senior Loan (4.0%, Due 2/13)	875	875	368
(Industrial Products)	**Total Investment**		**875**	**368**

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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[(1)(2)]**	**September 30, 2009 (unaudited) Principal**	**Cost**	**Value**
Network Hardware Resale, Inc.	Unitranche Debt (12.8%, Due 12/11)	$ 16,330	$ 16,382	$ 16,330
(Business Services)	Convertible Subordinated Debt (9.8%, Due 12/15)	15,953	16,000	16,000
	Total Investment		**32,382**	**32,330**
Novak Biddle Venture Partners III, L.P.(5)	Limited Partnership Interest		2,018	1,037
(Private Equity Fund)	**Total Investment**		**2,018**	**1,037**
Oahu Waste Services, Inc.	Stock Appreciation Rights		206	406
(Business Services)	**Total Investment**		**206**	**406**
Pangaea CLO 2007-1 Ltd.(4)	Class D Notes (5.3%, Due 1/21)	15,000	11,985	7,795
(CLO)	**Total Investment**		**11,985**	**7,795**
PC Helps Support, LLC	Senior Loan (4.3%, Due 12/13)	8,299	8,210	7,763
(Business Services)	Subordinated Debt (12.8%, Due 12/13)	27,121	27,013	25,572
	Total Investment		**35,223**	**33,335**
Performant Financial Corporation	Common Stock (478,816 shares)		734	920
(Business Services)	**Total Investment**		**734**	**920**
Promo Works, LLC	Unitranche Debt (12.3%, Due 12/11)	23,111	22,994	20,312
(Business Services)	**Total Investment**		**22,994**	**20,312**

Reed Group, Ltd.	Senior Loan (6.4%, Due 12/13)	12,060	11,929	9,530
(Healthcare Services)	Subordinated Debt (15.8%, Due 12/13)	19,076	19,013	14,924
	Equity Interests		1,800	
	Total Investment		**32,742**	**24,454**
S.B. Restaurant Company	Unitranche Debt (9.8%, Due 4/11)	38,327	38,184	33,606
(Retail)	Preferred Stock (46,690 shares)		117	
	Warrants		534	
	Total Investment		**38,835**	**33,606**
SPP Mezzanine Funding II, L.P.(5)	Limited Partnership Interest		7,605	6,987
(Private Equity Fund)	**Total Investment**		**7,605**	**6,987**
STS Operating, Inc.	Subordinated Debt (11.0%, Due 1/13)	30,386	30,313	27,305
(Industrial Products)	**Total Investment**		**30,313**	**27,305**
Summit Energy Services, Inc.	Common Stock (415,982 shares)		1,861	2,150
(Business Services)	**Total Investment**		**1,861**	**2,150**

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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[1][2]**	**Principal**	**September 30, 2009 (unaudited) Cost**	**Value**
Tappan Wire & Cable Inc.	Unitranche Debt (15.0%, Due 8/14)[6]	$ 22,346	$ 22,248	$ 4,515
(Business Services)	Common Stock (12,940 shares)[12]		2,043	
	Warrant[12]			
	Total Investment		**24,291**	**4,515**
The Step2 Company, LLC	Unitranche Debt (11.0%, Due 4/12)	94,602	94,396	89,550
(Consumer Products)	Equity Interests		2,156	1,528
	Total Investment		**96,552**	**91,078**
Tradesmen International, Inc.	Subordinated Debt (12.0%, Due 12/12)	40,000	39,793	18,347
(Business Services)	**Total Investment**		**39,793**	**18,347**
TransAmerican Auto Parts, LLC	Subordinated Debt (18.3%, Due 11/12)[6]	24,561	24,409	
(Consumer Products)	Equity Interests		1,033	
	Total Investment		**25,442**	
Trover Solutions, Inc.	Subordinated Debt (12.0%, Due 11/12)	56,676	56,510	52,568
(Business Services)	**Total Investment**		**56,510**	**52,568**
United Road Towing, Inc.	Subordinated Debt (11.8%, Due 1/14)	19,060	18,988	18,792
(Consumer Services)	**Total Investment**		**18,988**	**18,792**

Venturehouse-Cibernet Investors, LLC	Equity Interest			
(Business Services)	**Total Investment**			
WMA Equity Corporation and Affiliates	Subordinated Debt (16.8%, Due 4/13-4/14)[6]	139,455	138,559	71,345
d/b/a Wear Me Apparel	Common Stock (86 shares)		39,549	
(Consumer Products)	**Total Investment**		**178,108**	**71,345**
Webster Capital II, L.P.[5]	Limited Partnership Interest		1,338	809
(Private Equity Fund)	**Total Investment**		**1,338**	**809**
Woodstream Corporation	Subordinated Debt (12.0%, Due 2/15)	90,000	89,678	74,221
(Consumer Products)	Common Stock (6,960 shares)		6,961	2,000
	Total Investment		**96,639**	**76,221**
Other companies	Other debt investments	37	(151)	(151)
	Other equity investments		41	8
	Total Investment		**(110)**	**(143)**
Total companies less than 5% owned			**$ 1,948,748**	**$ 1,232,400**
Total private finance (113 portfolio investments)			**$ 4,194,269**	**$ 2,442,671**

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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	September 30, 2009 (unaudited) Cost	Value
Commercial Mortgage Loans				
	Up to 6.99%	3	$ 32,143	$ 31,006
	7.00% 8.99%	2	1,876	1,864
	9.00% 10.99%	1	6,476	6,476
	11.00% 12.99%	1	10,479	6,319
	15.00% and above	2	3,970	4,848
Total commercial mortgage loans[13]			**$ 54,944**	**$ 50,513**
Real Estate Owned			**$ 5,937**	**$ 6,179**
Equity Interests[2] Companies more than 25% owned			**$ 13,185**	**$ 11,831**
Total commercial real estate finance			**$ 74,066**	**$ 68,523**
Total portfolio			**$ 4,268,335**	**$ 2,511,194**

	Yield	Cost	Value
Investments in Money Market and Other Securities			
First American Treasury Obligations Fund		$ 90,020	$ 90,020
Total		$ 90,020	$ 90,020

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

(13) Commercial mortgage loans totaling $9.2 million at value were on non-accrual status and therefore were considered non-income producing.

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ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF INVESTMENTS

Private Finance Portfolio Company (in thousands, except number of shares)	**Investment[1][2]**		**December 31, 2008**	
		Principal	**Cost**	**Value**
Companies More Than 25% Owned				
AGILE Fund I, LLC[5]	Equity Interests		$ 694	$ 497
(Private Equity Fund)	**Total Investment**		**694**	**497**
AllBridge Financial, LLC	Equity Interests		33,294	10,960
(Asset Management)	**Total Investment**		**33,294**	**10,960**
	Standby Letter of Credit ($15,000)			
Allied Capital Senior Debt Fund, L.P.[5]	Limited Partnership Interests		31,800	31,800
(Private Debt Fund)	**Total Investment**		**31,800**	**31,800**
Avborne, Inc.[7] (Business Services)	Preferred Stock (12,500 shares)			942
	Common Stock (27,500 shares)			
	Total Investment			**942**
Avborne Heavy Maintenance, Inc.[7]	Common Stock (2,750 shares)			
(Business Services)	**Total Investment**			
Aviation Properties Corporation	Common Stock (100 shares)		93	
(Business Services)	**Total Investment**		**93**	
	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	
	Total Investment		**43,428**	**44,878**
Calder Capital Partners, LLC[5]	Senior Loan (10.5%, Due 5/09)[6]	4,496	4,496	953
(Asset Management)	Equity Interests		2,453	
	Total Investment		**6,949**	**953**
Callidus Capital Corporation	Subordinated Debt (18.0%, Due 8/13 2/14)	16,068	16,068	16,068
(Asset Management)	Common Stock (100 shares)			34,377
	Total Investment		**16,068**	**50,445**
	Guaranty ($6,447)			

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(7) Avborne, Inc. and Avborne Heavy Maintenance, Inc. are affiliated companies.

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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[1][2]**	**December 31, 2008 Principal**	**Cost**	**Value**
Ciena Capital LLC	Senior Loan (5.5%, Due 3/09)[6]	$ 319,031	$ 319,031	$ 104,883
(Financial Services)	Class B Equity Interests		119,436	
	Class C Equity Interests		109,301	
	Total Investment		**547,768**	**104,883**
	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
	Total Investment		**74,069**	**69,959**
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
	Total Investment		**51,858**	**55,465**
CR Holding, Inc.	Subordinated Debt (16.6%, Due 2/13)[6]	39,307	39,193	17,360
(Consumer Products)	Common Stock (32,090,696 shares)		28,744	
	Total Investment		**67,937**	**17,360**

Crescent Equity Corp.[8]	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)[6]	10,097	10,072	4,331
	Common Stock (174 shares)		81,255	4,580
	Total Investment		**114,007**	**23,627**
	Guaranty ($900)			
	Standby Letters of Credit ($200)			
Direct Capital Corporation	Subordinated Debt (16.0%, Due 3/13)[6]	55,671	55,496	13,530
(Financial Services)	Common Stock (2,317,020 shares)		25,732	
	Total Investment		**81,228**	**13,530**
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	
	Total Investment		**90,488**	**62,189**

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(8) Crescent Equity Corp. holds investments in Crescent Hotels & Resorts, LLC and affiliates.

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

(Industrial Products)	**Total Investment**		**13,500**	**14,860**
Impact Innovations Group, LLC	Equity Interests in Affiliate			321
(Business Services)	**Total Investment**			**321**
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)(6)	16,177	16,126	17,532
	Preferred Stock (25,000 shares)		25,000	4,068
	Common Stock (620,000 shares)		6,325	
	Total Investment		**93,189**	**67,427**
Jakel, Inc.	Subordinated Debt (15.5%, Due 3/08)(6)	748	748	374
(Industrial Products)	**Total Investment**		**748**	**374**
Knightsbridge CLO 2007-1 Ltd.(4)	Class E Notes (13.8%, Due 1/22)	18,700	18,700	14,866
(CLO)	Income Notes (14.9%)(11)		40,914	35,214
	Total Investment		**59,614**	**50,080**

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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[1][2]**	**December 31, 2008 Principal**	**Cost**	**Value**
Knightsbridge CLO 2008-1 Ltd.[4]	Class C Notes (9.3%, Due 6/18)	$ 12,800	$ 12,800	$ 12,800
(CLO)	Class D Notes (10.3%, Due 6/18)	8,000	8,000	8,000
	Class E Notes (6.8%, Due 6/18)	13,200	10,573	10,573
	Income Notes (16.6%)[11]		21,315	21,315
	Total Investment		**52,688**	**52,688**
MHF Logistical Solutions, Inc.	Subordinated Debt (13.0%, Due 6/12 6/13)[6]	49,841	49,633	
(Business Services)	Preferred Stock (10,000 shares)			
	Common Stock (20,934 shares)		20,942	
	Total Investment		**70,575**	
MVL Group, Inc.	Senior Loan (12.0%, Due 6/09 7/09)	30,674	30,663	30,663
(Business Services)	Subordinated Debt (14.5%, Due 6/09 7/09)	41,074	40,994	40,994
	Subordinated Debt (3.0%, Due 6/09)[6]	144	139	86
	Common Stock (560,716 shares)		555	
	Total Investment		**72,351**	**71,743**
Old Orchard Brands, LLC	Subordinated Debt (18.0%, Due 7/14)	18,951	18,882	18,882
(Consumer Products)	Equity Interests		16,857	27,763
	Total Investment		**35,739**	**46,645**

Penn Detroit Diesel Allison, LLC	Subordinated Debt (15.5%, Due 8/13)	37,984	37,869	37,869
(Business Services)	Equity Interests		18,873	21,100
	Total Investment		**56,742**	**58,969**
Service Champ, Inc.	Subordinated Debt (15.5%, Due 4/12)	27,050	26,984	26,984
(Business Services)	Common Stock (55,112 shares)		11,785	21,156
	Total Investment		**38,769**	**48,140**
Stag-Parkway, Inc.	Unitranche Debt (14.0%, Due 7/12)	17,975	17,920	17,962
(Business Services)	Common Stock (25,000 shares)		32,686	6,968
	Total Investment		**50,606**	**24,930**
Startec Equity, LLC	Equity Interests		211	332
(Telecommunications)	**Total Investment**		**211**	**332**
Senior Secured Loan Fund LLC	Subordinated Certificates (12.0)%		125,423	125,423
(Private Debt Fund)	Equity Interests		1	1
	Total Investment		**125,424**	**125,424**
Worldwide Express Operations, LLC	Subordinated Debt (14.0%, Due 2/14)(6)	2,865	2,722	2,032
(Business Services)	Equity Interests		11,384	
	Warrants		144	
	Total Investment		**14,250**	**2,032**
Total companies more than 25% owned			**$ 2,167,020**	**$ 1,187,722**

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

Mezzanine Fund, LLC[5] (Private Equity Fund)	**Total Investment**		**11,789**	**11,063**
Becker Underwood, Inc.	Subordinated Debt (14.5%, Due 8/12)	25,503	25,450	25,502
(Industrial Products)	Common Stock (4,376 shares)		5,014	2,267
	Total Investment		**30,464**	**27,769**
Drew Foam Companies, Inc.	Preferred Stock (622,555 shares)		623	512
(Business Services)	Common Stock (6,286 shares)		6	
	Total Investment		**629**	**512**
Driven Brands, Inc.	Subordinated Debt (16.5%, Due 7/15)	84,106	83,698	83,698
(Consumer Services)	Common Stock (3,772,098 shares)		9,516	4,855
	Total Investment		**93,214**	**88,553**
Hilden America, Inc.	Common Stock (19 shares)		454	76
(Consumer Products)	**Total Investment**		**454**	**76**
Lydall Transport, Ltd.	Equity Interests		432	345
(Business Services)	**Total Investment**		**432**	**345**
Multi-Ad Services, Inc.	Unitranche Debt (11.3%, Due 11/11)	3,018	2,995	2,941
(Business Services)	Equity Interests		1,737	1,782
	Total Investment		**4,732**	**4,723**

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(5) Non-registered investment company.

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

Companies Less Than 5% Owned				
3SI Security Systems, Inc.	Subordinated Debt (14.6%, Due 8/13)	$ 29,200	$ 29,118	$ 28,170
(Consumer Products)	**Total Investment**		**29,118**	**28,170**
Abraxas Corporation	Subordinated Debt (14.6%, Due 4/13)	36,822	36,662	36,170
(Business Services)	**Total Investment**		**36,662**	**36,170**
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
	Total Investment		**55,325**	**53,806**
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
	Total Investment		**14,481**	**11,662**

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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[1][2]**	**December 31, 2008 Principal**	**Cost**	**Value**
Baird Capital Partners IV Limited[5]	Limited Partnership Interest		$ 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)[12]		39,274	91,149
	Warrants[12]			
	Total Investment		**79,512**	**131,387**
Broadcast Electronics, Inc.	Senior Loan (8.8%, Due 11/11)[6]	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 CDO Fund I, Ltd.[4][10]	Class C Notes (12.9%, Due 12/13)	18,800	18,907	10,116
(CDO)	Class D Notes (17.0%, Due 12/13)	9,400	9,454	
	Total Investment		**28,361**	**10,116**
Callidus Debt Partners CLO Fund III, Ltd.[4][10]	Preferred Shares (23,600,000 shares)		20,138	5,402
(CLO)	**Total Investment**		**20,138**	**5,402**

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

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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[1][2]**	**December 31, 2008 Principal**	**Cost**	**Value**
Callidus MAPS CLO Fund I LLC[10] (CLO)	Class E Notes (7.0%, Due 12/17)	$ 17,000	$ 17,000	$ 9,813
	Income Notes (4.0%)[11]		45,053	27,678
	Total Investment		**62,053**	**37,491**
Callidus MAPS CLO Fund II, Ltd.[4][10] (CLO)	Class D Notes (8.8%, Due 7/22)	7,700	3,555	2,948
	Income Notes (13.3%)[11]		18,393	12,626
	Total Investment		**21,948**	**15,574**
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
	Total Investment		**4,482**	**4,082**
Catterton Partners VI, L.P.[5]	Limited Partnership Interest		2,812	2,356
(Private Equity Fund)	**Total Investment**		**2,812**	**2,356**
Centre Capital Investors V, L.P.[5]	Limited Partnership Interest		3,049	2,344
(Private Equity Fund)	**Total Investment**		**3,049**	**2,344**
CK Franchising, Inc.	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
	Total Investment		**29,780**	**33,104**

Commercial Credit Group, Inc.	Subordinated Debt (15.0%, Due 6/15)	19,000	18,970	18,970
(Financial Services)	Preferred Stock (64,679 shares)		15,543	9,073
	Warrants			
	Total Investment		**34,513**	**28,043**
Community Education Centers, Inc.	Subordinated Debt (14.5%, Due 11/13)	35,548	35,486	34,056
(Education Services)	**Total Investment**		**35,486**	**34,056**
Component Hardware Group, Inc.	Subordinated Debt (13.5%, Due 1/13)	18,710	18,654	18,261
(Industrial Products)	**Total Investment**		**18,654**	**18,261**
Cook Inlet Alternative Risk, LLC	Unitranche Debt (10.8%, Due 4/13)	90,000	89,619	82,839
(Business Services)	Equity Interests		552	
	Total Investment		**90,171**	**82,839**
Cortec Group Fund IV, L.P.(5)	Limited Partnership Interest		4,647	3,445
(Private Equity)	**Total Investment**		**4,647**	**3,445**

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

EarthColor, Inc.	Subordinated Debt (15.0%, Due 11/13)(6)	123,819	123,385	77,243
(Business Services)	Common Stock (63,438 shares)(12)		63,438	
	Warrants(12)			
	Total Investment		**186,823**	**77,243**
eCentury Capital Partners, L.P.(5)	Limited Partnership Interest		7,274	1,431
(Private Equity Fund)	**Total Investment**		**7,274**	**1,431**
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
	Total Investment		**36,295**	**33,370**
Farley s & Sathers Candy Company, Inc.	Subordinated Debt (10.1%, Due 3/11)	2,500	2,493	2,365
(Consumer Products)	**Total Investment**		**2,493**	**2,365**

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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[1][2]**	**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)	**Total Investment**		**28,220**	**27,340**
Fidus Mezzanine Capital, L.P.[5]	Limited Partnership Interest		9,597	6,754
(Private Equity Fund)	**Total Investment**		**9,597**	**6,754**
Freedom Financial Network, LLC	Subordinated Debt (13.5%, Due 2/14)	13,000	12,945	12,811
(Financial Services)	**Total Investment**		**12,945**	**12,811**
Geotrace Technologies, Inc.	Warrants		2,027	3,000
(Energy Services)	**Total Investment**		**2,027**	**3,000**
Gilchrist & Soames, Inc.	Subordinated Debt (13.4%, Due 10/13)	25,800	25,660	24,692
	Total Investment		**25,660**	**24,692**
Havco Wood Products LLC	Equity Interests		910	400
(Industrial Products)	**Total Investment**		**910**	**400**
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)[12]		23,695	27,335
	Warrant[12]			

	Total Investment		**76,783**	**80,423**
The Hillman Companies, Inc.[3]	Subordinated Debt (10.0%, Due 9/11)	44,580	44,491	44,345
(Consumer Products)	**Total Investment**		**44,491**	**44,345**
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	
	Total Investment		**26,148**	**23,548**
Ideal Snacks Corporation	Senior Loan (5.3%, Due 6/10)	1,496	1,496	1,438
(Consumer Products)	**Total Investment**		**1,496**	**1,438**

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(4) Non-U.S. company or principal place of business outside the U.S.

(5) Non-registered investment company.

(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)

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

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

(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.

(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)

Private Finance Portfolio Company (in thousands, except number of shares)	**Investment[1][2]**	**December 31, 2008 Principal**	**Cost**	**Value**
Peter Brasseler Holdings, LLC	Equity Interests		$ 3,451	$ 2,900
(Business Services)	**Total Investment**		**3,451**	**2,900**
PharMEDium Healthcare Corporation	Senior Loan (4.3%, Due 10/13)	$ 1,910	1,910	1,747
(Healthcare Services)	**Total Investment**		**1,910**	**1,747**
Postle Aluminum Company, LLC	Unitranche Debt (13.0%, Due 10/12)[6]	58,953	58,744	9,978
(Industrial Products)	Equity Interests		2,174	
	Total Investment		**60,918**	**9,978**
Pro Mach, Inc.	Subordinated Debt (12.5%, Due 6/12)	14,616	14,573	14,089
(Industrial Products)	Equity Interests		1,294	1,900
	Total Investment		**15,867**	**15,989**
Promo Works, LLC	Unitranche Debt (12.3%, Due 12/11)	23,111	22,954	21,266
(Business Services)	**Total Investment**		**22,954**	**21,266**
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
	Total Investment		**33,027**	**28,485**
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	
	Total Investment		**36,946**	**35,031**
	Standby Letters of Credit ($2,465)			
Snow Phipps Group, L.P.[5]	Limited Partnership Interest		4,785	4,374
(Private Equity Fund)	**Total Investment**		**4,785**	**4,374**
SPP Mezzanine Funding II, L.P.[5]	Limited Partnership Interest		9,362	9,269
(Private Equity Fund)	**Total Investment**		**9,362**	**9,269**
STS Operating, Inc.	Subordinated Debt (11.0%, Due 1/13)	30,386	30,296	29,745
(Industrial Products)	**Total Investment**		**30,296**	**29,745**
Summit Energy Services, Inc.	Subordinated Debt (11.6%, Due 8/13)	35,730	35,547	32,113
	Common Stock (415,982 shares)		1,861	1,900
	Total Investment		**37,408**	**34,013**
Tank Intermediate Holding Corp.	Senior Loan (7.1%, Due 9/14)	30,514	29,539	25,937
	Total Investment		**29,539**	**25,937**

(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.

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

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

(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
Commercial Mortgage Loans				
	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
Total commercial mortgage loans[13]			**$ 52,547**	**$ 53,502**
Real Estate Owned			**$ 18,201**	**$ 20,823**
Equity Interests[2] Companies more than 25% owned			**$ 14,755**	**$ 19,562**
Guarantees ($6,871)				
Standby Letter of Credit ($650)				
Total commercial real estate finance			**$ 85,503**	**$ 93,887**
Total portfolio			**$ 4,962,895**	**$ 3,492,950**

	Yield	Cost	Value
Investments in Money Market and Other Securities			
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

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 Accounting Standards Codification (ASC) Topic 810 *Consolidations* , 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.

Note 2. Summary of Significant Accounting Policies

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.

In June 2009, the FASB issued SFAS No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles,* which was primarily codified into ASC Topic 105, *Generally Accepted Accounting Standards.* This standard is the single source of authoritative non-governmental U.S. generally accepted accounting principles (GAAP), superseding existing FASB, American Institute of Certified Public Accountants (AICPA), Emerging Issues Task Force (EITF), and related accounting literature. Also included is relevant Securities and Exchange Commission guidance organized using the same topical structure in separate sections. This guidance is effective for financial statements issued for reporting periods that end after September 15, 2009. This guidance impacts the Company s consolidated financial statements and related disclosures as all references to authoritative literature reflect the newly adopted codification.

The accompanying unaudited consolidated financial statements of the Company have been prepared in accordance with 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 September 30, 2009, the results of operations for the three and nine months ended September 30, 2009 and 2008, and changes in net assets and cash flows for the nine months ended September 30, 2009 and 2008. The results of operations for the three and nine months

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2. Summary of Significant Accounting Policies, continued

ended September 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 ASC Topic 820 *Financial Instruments*, which codified FASB Statement No. 157, *Fair Value Measurements.* 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 the standards in ASC Topic 820 on a prospective basis in the first quarter of 2008. These standards require 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 with the standards, 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-

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2. Summary of Significant Accounting Policies, continued

use premise of value (as defined in ASC Topic 820), 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. 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 ASC Topic 820, 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 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 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

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ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2. Summary of Significant Accounting Policies, continued

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 ASC Topic 820 (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 ASC Topic 820.

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 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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2. Summary of Significant Accounting Policies, continued

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

Cash and Cash Equivalents

Cash and cash equivalents represents unrestricted cash and highly liquid securities with original maturities of 90 days or less.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2. Summary of Significant Accounting Policies, continued

Guarantees

Guarantees meeting the characteristics described in ASC Topic 460, *Guarantees* 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), which was primarily codified into ASC Topic 718, *Compensation Stock Compensation* . These standards were 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 these standards. With respect to options granted on or after January 1, 2006, compensation cost based on estimated grant date fair value is recognized over the related service period in the statement of operations.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2. Summary of Significant Accounting Policies, continued

The stock option expense for the three and nine months ended September 30, 2009 and 2008, was as follows:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
($ in millions, except per share amounts)	**2009**	**2008**	**2009**	**2008**
Employee Stock Option Expense:				
Previously awarded, unvested options as of January 1, 2006	$	$	$	$3.9
Options granted on or after January 1, 2006	0.4	1.5	2.4	5.6
Total employee stock option expense	$0.4	$1.5	$2.4	$9.5
Per basic share	$0.00	$0.01	$0.01	$0.06
Per diluted share	$0.00	$0.01	$0.01	$0.06

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 nine months ended September 30, 2009 and 2008:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2009	**2008**	**2009**	**2008**
Expected term (in years)		5.0	3.0	5.0
Risk-free interest rate		3.4%	1.3%	2.8%
Expected volatility		32.8%	105.0%	27.8%
Dividend yield		8.5%	32.5%	8.5%
Weighted average fair value per option		$1.81	$0.21	$2.18

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 $3.4 million, $3.9 million, and

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2. Summary of Significant Accounting Policies, continued

$4.0 million for the years ended December 31, 2009, 2010, and 2011, respectively. This estimate may 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 September 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 September 30, 2009, is expected to be recognized over an estimated weighted-average period of 1.30 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 will generally 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 3,814,040 shares and 5,703 shares were not included in the calculation of diluted earnings (loss) per common share for the nine months ended September 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 GAAP 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.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2. Summary of Significant Accounting Policies, continued

The consolidated financial statements include portfolio investments at value of $2.5 billion and $3.5 billion at September 30, 2009, and December 31, 2008, respectively. At September 30, 2009, and December 31, 2008, 88% 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 was primarily codified into ASC Topic 820, defines fair value, establishes a framework for measuring fair value in GAAP, 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.

ASC Topic 820 also includes the codification of *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active* (FSP 157-3), which was issued by the FASB in October 2008. These provisionsapply to financial assets within the scope of accounting pronouncements that require or permit fair value measurements in accordance with ASC Topic 820. These provisions of ASC Topic 820 provide clarification in a market that is not active and provide an example to illustrate key considerations in determining the fair value.

The Company applied these provisions of ASC Topic 820 relating to determining the fair value of a financial asset when the market for that asset is not active, in determining the fair value of its portfolio investments at December 31, 2008. The application of these provisions did not have a material impact on the Company s consolidated financial position or its results of operations.

ASC Topic 820 also includes the codification of *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), which was issued by the FASB in April 2009. These provisions provide guidance on how to determine the fair value of assets under ASC Topic 820 in the current economic environment and reemphasize 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. These provisions state 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.

The Company adopted these provisions of ASC Topic 820 on a prospective basis beginning in the quarter ending March 31, 2009. The adoption of these provisions did not have a material effect on the Company s consolidated financial statements.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2. Summary of Significant Accounting Policies, continued

The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115, which was primarily codified into ASC Topic 320. In February 2007, the FASB issued Statement No. 159, which was primarily codified into ASC Topic 825, 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.

Subsequent Events (SFAS 165), which was primarily codified into ASC Topic 855. 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. This standard 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 these provisions of ASC 855 in the quarter ended June 30, 2009. The adoption of these provisions did not have a material impact on the Company s financial statements.

Accounting for Transfers of Financial Assets (SFAS 166), which has not yet been codified. 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.

Amendments to FASB Interpretation No. 46(R) (SFAS 167), which will be codified into ASC Topic 810, *Consolidation*. In June 2009, the FASB issued SFAS 167, which amends the guidance on accounting for variable interest entities. SFAS 167 is effective for fiscal years beginning after November 15, 2009 and interim periods within that fiscal year. The Company has not completed the process of evaluating the impact of adopting this standard.

The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles (SFAS 168), which was primarily codified into Topic 105, was issued by the FASB in July 2009 This standard, which supersedes SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles*, establishes the FASB Accounting Standards Codification, which will become the source of authoritative GAAP recognized by the FASB. This standard is effective for the period ending after September 15, 2009. The implementation of this standard did not 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 September 30, 2009, and December 31, 2008, the private finance portfolio consisted of the following:

	2009			2008		
($ in millions)	**Cost**	**Value**	**Yield[(1)]**	**Cost**	**Value**	**Yield[(1)]**
Loans and debt securities:						
Senior loans	$ 553.1	$ 289.4	4.8%	$ 556.9	$ 306.3	5.6%
Unitranche debt[(2)]	424.9	374.7	12.2%	527.5	456.4	12.0%
Subordinated debt[(3)]	1,770.9	1,182.9	13.4%	2,300.1	1,829.1	12.9%
Total loans and debt securities[(4)]	2,748.9	1,847.0	11.8%	3,384.5	2,591.8	11.9%
Equity securities:						
Preferred shares/income notes of CLOs[(5)]	245.0	84.4	12.1%	248.2	179.2	16.4%
Subordinated certificates in Senior Secured Loan Fund LLC[(5)]	165.2	165.0	14.0%	125.4	125.4	12.0%
Other equity securities	1,035.2	346.3		1,119.3	502.7	
Total equity securities	1,445.4	595.7		1,492.9	807.3	
Total	$ 4,194.3	$ 2,442.7		$ 4,877.4	$ 3,399.1	

(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. At September 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 $102.2 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) effective interest yield on the subordinated certificates 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 $2,775.9 million and $3,418.0 million at September 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 $27.0 million and $33.5 million at September 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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3. Portfolio, continued

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 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 September 30, 2009, 80% of the private finance loans and debt securities had a fixed rate of interest and 20% 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 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 service 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 September 30, 2009, the senior secured loan to Ciena had a cost

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3. Portfolio, continued

basis of $319.0 million and a value of $102.2 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.

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

	September 30, 2009		December 31, 2008	
($ in millions)	**Cost**	**Value**	**Cost**	**Value**
Senior Loan	$ 319.0	$ 102.2	$ 319.0	$ 104.9
Class B Equity Interests[1]	119.5		119.5	
Class C Equity Interests[1]	109.1		109.3	
Total[2]	$ 547.6	$ 102.2	$ 547.8	$ 104.9

(1) At September 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 nine months ended September 30, 2009, the Company funded $97.4 million to support Ciena s term securitizations in lieu of draws under related standby letters of credit, including the funding of $46.0 million during the third quarter of 2009. This was required primarily as a result of the issuer of the letters of credit not extending maturing standby letters of credit that were issued under the Company s former revolving line of credit. The amounts funded were recorded as other assets in the accompanying consolidated balance sheet. At September 30, 2009 and December 31, 2008, other assets included amounts receivable from or related to Ciena totaling $112.7 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 $36.8 million and $99.8 million for the three and nine months ended September 30, 2009, respectively. Net change in unrealized appreciation or depreciation included a net decrease in the Company s investment in and receivables from Ciena of $151.9 million and $220.5 million for the three and nine months ended September 30, 2008, respectively.

At September 30, 2009, the Company had no outstanding standby letters of credit issued under the Company s former line of credit. The Company has considered the letters of credit and the funding thereof in the valuation of Ciena at September 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 nine months ended September 30, 2009 and 2008.

At September 30, 2009, Ciena had one non-recourse securitization SBA loan warehouse facility, which has reached its maturity date but remains outstanding. Ciena is working with the providers of the SBA loan warehouse facility with regard to the repayment of that facility. The Company has issued a performance guaranty 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 Ciena s

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3. Portfolio, continued

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 and the funding thereof, current regulatory issues, ongoing investigations and litigation in performing the valuation of Ciena at September 30, 2009 and at December 31, 2008.

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

		2009			2008	
($ in millions)	**Cost**	**Value**	**Yield(1)**	**Cost**	**Value**	**Yield(1)**
Bonds(2):						
Callidus Debt Partners CDO Fund I, Ltd.	$ 29.0	$ 2.9	%	$ 28.4	$ 10.1	39.4%
Callidus Debt Partners CLO Fund IV, Ltd.	2.1	1.6	20.9%	2.0	1.4	26.9%
Callidus Debt Partners CLO Fund VI, Ltd.	7.6	3.8	21.4%	7.1	3.9	26.1%
Callidus MAPS CLO Fund I LLC	17.0	11.4	8.6%	17.0	9.8	12.2%
Callidus MAPS CLO Fund II LLC	3.8	3.1	25.1%	3.6	3.0	30.2%
Dryden XVIII Leveraged Loan 2007 Limited	7.9	2.4	%	7.7	4.5	20.5%
Knightsbridge CLO 2007-1 Ltd.(3)	18.7	11.2	15.9%	18.7	14.9	17.4%
Knightsbridge CLO 2008-1 Ltd.(3)	31.9	29.1	11.3%	31.4	31.4	10.2%
Pangaea CLO 2007-1 Ltd.	12.0	7.8	16.8%	11.8	7.1	25.0%
Total bonds	130.0	73.3	12.7%	127.7	86.1	18.5%
Preferred Shares/Income Notes:						
Callidus Debt Partners CLO Fund III, Ltd.	20.1	2.2	%	20.1	5.4	%
Callidus Debt Partners CLO Fund IV, Ltd.	14.9	4.4	%	14.6	10.6	18.1%
Callidus Debt Partners CLO Fund V, Ltd.	13.5	4.6	7.6%	13.4	10.3	21.3%
Callidus Debt Partners CLO Fund VI, Ltd.	29.1	4.2	%	28.3	23.1	21.8%

Callidus Debt Partners CLO Fund VII, Ltd.	24.8	5.4	%	24.0	15.4	17.9%
Callidus MAPS CLO Fund I LLC	41.2	13.7	%	45.1	27.8	6.5%
Callidus MAPS CLO Fund II, Ltd.	18.1	4.8	3.4%	18.4	12.6	19.3%
Dryden XVIII Leveraged Loan 2007 Limited	23.2	2.4	%	22.1	17.5	20.2%
Knightsbridge CLO 2007-1 Ltd.[(3)]	38.8	22.6	22.8%	40.9	35.2	17.4%
Knightsbridge CLO 2008-1 Ltd.[(3)]	21.3	20.1	22.5%	21.3	21.3	16.6%
Total preferred shares/income notes	245.0	84.4	12.1%	248.2	179.2	16.4%
Total	$ 375.0	$ 157.7		$ 375.9	$ 265.3	

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3. Portfolio, continued

(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. Any remaining cash flow is then 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 September 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 September 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 627 issuers and 658 issuers, respectively, and had balances as follows:

($ in millions)	**2009**	**2008**
Bonds	$ 232.3	$ 268.3
Syndicated loans	4,387.2	4,477.3
Cash[1]	107.9	89.6
Total underlying collateral assets at cost[2]	$ 4,727.4	$ 4,835.2

(1) Includes undrawn liability amounts.
(2) At September 30, 2009, and December 31, 2008, the total cost basis of defaulted obligations was $139.6 million and $95.0 million, respectively, or approximately 3.0% and 2.0% respectively, of the total underlying collateral assets.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3. Portfolio, continued

Loans and Debt Securities on Non-Accrual Status. At September 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	$ 194.2	$ 176.1
Companies 5% to 25% owned	15.3	
Companies less than 5% owned	96.3	151.8
Total	$ 305.8	$ 327.9

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

	2009	**2008**
Industry		
Business services	32%	36%
Consumer products	28	24
Private debt funds	8	6
Financial services	8	5
CLO/CDO[1]	6	8
Consumer services	5	5
Industrial products	3	5
Retail	2	5
Healthcare services	2	2
Other	6	4
Total	100%	100%
Geographic Region[2]		
Mid-Atlantic	42%	41%
Midwest	30	28
Southeast	15	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.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3. Portfolio, continued

Commercial Real Estate Finance

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

	2009			2008		
($ in millions)	**Cost**	**Value**	**Yield[(1)]**	**Cost**	**Value**	**Yield[(1)]**
Commercial mortgage loans	$ 54.9	$ 50.5	6.9%	$ 52.5	$ 53.5	7.4%
Real estate owned	5.9	6.2		18.2	20.8	
Equity interests	13.2	11.8		14.8	19.6	
Total	$ 74.0	$ 68.5		$ 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 September 30, 2009, and December 31, 2008, approximately 63% and 69% of the Company s commercial mortgage loan portfolio was composed of fixed interest rate loans, respectively, and 37% and 31% of the Company s commercial loan portfolio was composed of adjustable interest rate loans, respectively. At September 30, 2009, and December 31, 2008, loans with a value of $9.2 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 potential investment appreciation and ultimate realized gain on sale.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3. Portfolio, continued

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

	2009	2008
Property Type		
Hospitality	54%	52%
Recreation	30	22
Office	14	15
Retail		9
Other	2	2
Total	100%	100%
Geographic Region		
Southeast	46%	43%
West	32	26
Midwest	13	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 ASC Topic 820. 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.

ASC Topic 820 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

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.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3. Portfolio, continued

The Company has $90.0 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 September 30, 2009, were as follows:

($ in millions)	Fair Value Measurement as of September 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	$ 1,847.0	$	$	$ 1,847.0
Preferred shares/income notes of CLOs	84.4			84.4
Subordinated certificates in Senior Secured Loan Fund LLC	165.0			165.0
Other equity securities	346.3			346.3
Commercial real estate finance	68.5			68.5
Total portfolio	$ 2,511.2	$	$	$ 2,511.2

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

($ in millions)	Private Finance Loans and Debt Securities	Preferred Shares/ Income Notes of CLOs	Subordinated Certificates in Senior Secured Fund LLC	Other Equity Securities	Commercial 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)[(1)]	(116.5)	11.7		(40.9)	(3.7)	(149.4)
Net change in unrealized appreciation or depreciation[(2)]	(109.2)	(91.5)	(0.2)	(72.3)	(13.9)	(287.1)

Purchases, issuances, repayments and exits, net[3]	(519.1)	(15.0)	39.8	(43.2)	(7.8)	(545.3)
Transfers in and/or out of level 3						
Balance at September 30, 2009	$ 1,847.0	$ 84.4	$ 165.0	$ 346.3	$ 68.5	$ 2,511.2
Net unrealized appreciation (depreciation) during the period relating to assets still held at the reporting date[2]	$ (205.0)	$ (91.5)	$ (0.2)	$ (89.9)	$ (15.3)	$ (401.9)

(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. The net change in unrealized appreciation or depreciation in the consolidated statement of operations also includes the change in value of escrow and other receivables from portfolio companies that are included in other assets on the consolidated balance sheet.

(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).

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 and

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3. Portfolio, continued

broadly syndicated senior secured loans. At September 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.

In the first quarter of 2009, the Company completed 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 assets of the Managed Funds at September 30, 2009 and December 31, 2008, and the Company s management fees as of September 30, 2009, were as follows:

($ in millions) Name of Fund	Assets of Managed Funds September 30, 2009	 December 31, 2008	Management Fee[2]
Senior Secured Loan Fund LLC[3]	$ 921.2	$ 789.8	0.375%
Allied Capital Senior Debt Fund, L.P.	351.4	412.9	1.625%[1][2]
Knightsbridge CLO 2007-1 Ltd.	500.7	500.6	0.600%
Knightsbridge CLO 2008-1 Ltd.	304.6	304.8	0.600%
Emporia Preferred Funding I, Ltd.	419.8		0.625%[1]
Emporia Preferred Funding II, Ltd.	355.7		0.650%[1]
Emporia Preferred Funding III, Ltd.	406.1		0.650%[1]
AGILE Fund I, LLC	83.5	99.3	[1]
Total Assets	$ 3,343.0	$ 2,107.4	

(1) In addition to the management fees, 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. In October 2009, the Company sold its investment, including the outstanding commitments and the provision of management services, in the Senior Secured Loan Fund LLC. See Note 14. Subsequent Events.

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 relevant Managed Fund. The Company may pay a portion of management fees it receives to Callidus Capital Corporation, a wholly owned portfolio investment , 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 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.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3. Portfolio, continued

The Company accounts for the sale of securities to funds with which it has continuing involvement as sales pursuant to ASC Topic 860, 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 nine months ended September 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 nine months ended September 30, 2008, the Company sold assets to certain of the Managed Funds, for which the Company received proceeds of $352.7 million, and recognized realized gains of $2.8 million.

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

($ in millions)		**September 30, 2009**		**December 31, 2008**	
Name of Fund	**Investment Description**	**Cost**	**Value**	**Cost**	**Value**
Senior Secured Loan Fund LLC[1]	Subordinated Certificates and Equity Interests	$ 165.2	$ 165.0	$ 125.4	$ 125.4
Allied Capital Senior Debt Fund, L.P.	Equity interests	31.8	33.0	31.8	31.8
Knightsbridge CLO 2007-1 Ltd.	Class E Notes and Income Notes	57.4	33.8	59.6	50.1
Knightsbridge CLO 2008-1 Ltd.	Class C Notes, Class D Notes, Class E Notes and Income Notes	53.2	49.2	52.7	52.7
AGILE Fund I, LLC	Equity Interests	0.7	0.4	0.7	0.5
Total		$ 308.3	$ 281.4	$ 270.2	$ 260.5

(1) 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. In October 2009, the Company sold its investment, including the outstanding commitments and the provision of management services, in the Senior Secured Loan Fund LLC. See Note 14. Subsequent Events.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 4. Debt

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

	2009			2008		
($ in millions)	**Facility Amount**	**Amount Drawn at par**	**Annual Interest Cost[1]**	**Facility Amount**	**Amount Drawn at par**	**Annual Interest Cost[1]**
Notes payable:						
Privately issued secured notes payable (formerly unsecured)[5]	$ 841.0	$ 841.0[6]	13.8%	$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	1,586.5	1,586.5	10.5%	1,895.0	1,895.0	7.3%
Bank secured term debt (former revolver)[4]	50.0	50.0	17.0%[2]	632.5	50.0	4.3%[2]
Total debt	$ 1,636.5	$ 1,636.5	10.7%[3]	$2,527.5	$1,945.0	7.7%[3]

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

(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 $4.3 million at September 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 bank term debt 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) During the three months ended September 30, 2009, the commitments under the facility were reduced to $50.0 million subsequent to the funding of $46.0 million to Ciena securitizations in lieu of draws under letters of credit issued under the facility.

(5) In the third quarter of 2009, the Company completed the restructuring of its private notes.

(6) The notes payable on the consolidated balance sheet are shown net of OID of approximately $42.6 million as of September 30, 2009.

Debt Restructure

On August 28, 2009, the Company completed a comprehensive restructuring of its private notes (the Notes) and its bank facility (the Facility). Beginning in January 2009, the Company engaged in 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 Facility and the Notes due to certain covenant defaults. As of December 31, 2008, the Company s asset coverage was less than the 200% then required by the revolving credit facility and the private notes. Asset coverage generally refers to the percentage resulting from assets less accounts payable and other liabilities, divided by total debt.

In connection with the restructuring, the Company granted the Noteholders and the Lenders a pari-passu blanket lien on a substantial portion of its assets, including a substantial portion of the assets of the Company s consolidated subsidiaries.

The financial covenants applicable to the Notes and the Facility were modified as part of the restructuring. The Consolidated Debt to Consolidated Shareholders Equity covenant and the Capital Maintenance covenant were both eliminated. The Asset Coverage ratio was set at 1.35:1 initially, increasing to 1.4:1 at June 30, 2010 and to 1.55:1 at June 30, 2011, and maintained at that level thereafter. A new covenant, Total Adjusted Assets to Secured Debt, was set at 1.75:1 initially, increasing to 2.0:1 at June 30, 2010 and to 2.25:1 at June 30, 2011, and maintained at that level thereafter. The ratio of Adjusted EBIT to Adjusted Interest Expense was set at 1.05:1 initially, decreasing to 0.95:1 at December 31, 2009, 0.80:1 at March 31, 2010 and 0.75:1 at June 30, 2010. The covenant will then be increased to 0.80:1 on December 31, 2010 and 0.95:1 on December 31, 2011 and maintained at that level thereafter. At September 30, 2009, the Company was in compliance with these financial covenants.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 4. Debt, continued

The Notes and Facility impose certain limitations on the Company s ability to incur additional indebtedness, including precluding the Company from incurring additional indebtedness unless its asset coverage of all outstanding indebtedness is at least 200%. 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%. At September 30, 2009, the Company s asset coverage ratio was 175%, which is less than the 200% requirement. As a result, the Company will not be able to issue additional indebtedness until such time as its asset coverage returns to at least 200%.

The Company is required to apply 50% of all net cash proceeds from asset sales to the repayment of the Notes and 6% of all net cash proceeds from asset sales to the repayment of the Facility, subject to certain conditions and exclusions. In the case of certain events of default, the Company would be required to apply 100% of all net cash proceeds from asset sales to the repayment of its secured lenders. Under the new agreements, subject to a limit and certain liquidity restrictions, the Company may repurchase its public debt; however, the Company is prohibited from repurchasing its common stock and may not pay dividends in excess of the minimum the Company reasonably believes is required to maintain its tax status as a regulated investment company. In addition, upon the occurrence of a change of control (as defined in the Note Agreement and Credit Agreement), the Noteholders have the right to be prepaid in full and the Company is required to repay in full all amounts outstanding under the Facility.

The Note Agreement and Credit Agreement provide for customary events of default, including, but not limited to, payment defaults, breach of representations or covenants, cross-defaults, bankruptcy events and failure to pay judgments. Certain of these events of default are subject to notice and cure periods or materiality thresholds. Pursuant to the terms of the Notes, the occurrence of an event of default generally permits the holders of more than 50% in principal amount of outstanding Notes to accelerate repayment of all amounts due thereunder. The occurrence of an event of default would generally permit the administrative agent for the lenders under the Facility, or the holders of more than 51% of the aggregate principal debt outstanding under the Facility, to accelerate repayment of all amounts outstanding thereunder. Pursuant to the Notes, during the continuance of an event of default, the rate of interest applicable to the Notes would increase by 200 basis points. Pursuant to the terms of the Facility, during the continuance of an event of default, the applicable spread on any borrowings outstanding under the Facility would increase by 200 basis points.

In connection with the restructuring, the Company recorded a loss on the extinguishment of debt of $117.5 million. In addition to the $11 million of previously deferred unamortized debt costs associated with the Notes and Facility, the Company incurred and paid costs to the lenders of $146 million and other third party advisory and other fees of approximately $26 million in connection with the restructuring. Approximately $20 million of the restructuring costs were deferred and are being amortized into interest expense over the life of the Notes and Facility. In addition, the Company recorded approximately $45 million of original issue discount (OID) related to the restructuring of the Notes, which is being amortized into interest expense over the life of the Notes. After giving effect to the restructuring and the recording of the loss, the Company estimates that the weighted average interest cost,

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 4. Debt, continued

including amortization of the deferred debt cost and OID, for the Notes is approximately 13.75% and the for Facility is approximately 17%. The loss on extinguishment of debt is comprised of the following:

($ in millions)	
Previously deferred unamortized costs	$ 11.3
Fees paid to Noteholders/Lenders	145.9
Advisory and other fees paid	26.0
Costs deferred and amortizing into interest expense	(20.3)
OID recorded and amortizing into interest expense	(45.4)
Loss on extinguishment of debt	$ 117.5

Privately Issued Notes Payable. The Company had $1,015.0 million of Notes outstanding at June 30, 2009. The Company made principal payments on the Notes at and prior to the closing of the restructuring and had $841.0 million of Notes outstanding following the closing of the restructuring.

In connection with the restructuring, the existing Notes were exchanged for three new series of Notes containing the following terms:

($ in millions)	**Principal Amount**	**Maturity Dates**	**Annual Stated Interest Rate Through December 31, 2009[(1)]**	**Annual Stated Interest Rate Beginning January 1, 2010[(1)]**	**Annual Stated Interest Rate Beginning January 1, 2011[(1)]**	**Annual Stated Interest Rate Beginning January 1, 2012[(1)]**
Series A	$ 253.8	June 15, 2010	8.50%	9.25%	N/A	N/A
Series B	$ 253.8	June 15, 2011	9.00%	9.50%	9.75%	N/A
Series C	$ 333.5	March 31 & April 1, 2012	9.50%	10.00%	10.25%	10.75%

(1) The Notes generally require payment of interest quarterly.

The Company made various cash payments in connection with the restructuring of its Notes. The Company paid an amendment fee at closing of $15.2 million. In addition, the Company paid a make-whole fee of $79.7 million related to a contractual provision in the old Notes. Due to the payment of this make-whole fee, the new Notes have no significant make-whole requirement. The Company also paid a restructuring fee of $50.0 million at closing, which will be applied toward the principal balance of the Notes if the Notes are refinanced in full on or before January 31, 2010.

Bank Facility. At June 30, 2009, the Company had an unsecured revolving line of credit that was due to expire on April 11, 2011. The Company s Facility was restructured from a revolving facility to a term facility maturing on November 13, 2010. Total commitments under the Facility were reduced at closing to $96.0 million from $115.0 million prior to closing. At closing, there were $50.0 million of borrowings and $46.0 million of standby letters of credit (LCs) outstanding under the Facility. The $46.0 million of LCs terminated and/or expired prior to September 30, 2009 and the commitments under the Facility were reduced by a commensurate amount. As a result, the total commitment and outstanding balance was $50.0 million at September 30, 2009.

Borrowings under the Facility bear interest at a floating rate of interest, subject to a floor. The floating rate spread increases by 0.5% per annum beginning on January 1, 2010 and continuing through maturity. At closing, the interest rate on the Facility was 8.5% per annum. The Facility requires the

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 4. Debt, continued

payment of a commitment fee equal to 0.50% per annum of the committed amount. In addition, the Company agreed to pay an amendment fee at closing of $1.0 million, and a restructuring fee payable on January 31, 2010 equal to 1.0% of the outstanding borrowings on such date if the Facility remains outstanding. The Facility generally requires payments of interest no less frequently than quarterly.

Publicly Issued Unsecured Notes Payable. At September 30, 2009, the Company 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. 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 nine months ended September 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 $83.5 million for the nine months ended September 30, 2009.

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 September 30, 2009, the Company s asset coverage ratio was 175%.

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

	Amount Maturing at Par	
	Privately Issued	**Publicly Issued**

($ in millions) Year	Bank Secured Term Debt	Secured Notes Payable	Unsecured Notes Payable	Total
2009	$	$	$	$
2010	50.0	253.7		303.7
2011		253.8	319.9	573.7
2012		333.5	195.6	529.1
2013				
Thereafter			230.0	230.0
Total	$ 50.0	$ 841.0	$ 745.5	$ 1,636.5

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ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 4. Debt, continued

Fair Value of Debt

The Company records debt at cost. The fair value of the Company s outstanding debt was approximately $1.4 billion and $1.4 billion at September 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 September 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 had been issued through Bank of America, N.A. As of September 30, 2009, and December 31, 2008, the Company had issued guarantees of debt and rental obligations aggregating $9.1 million and $19.2 million, respectively, and had extended standby letters of credit aggregating $0.0 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 $9.1 million and $141.5 million at September 30, 2009, and December 31, 2008, respectively.

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

(in millions)	Total	2009	2010	2011	2012	2013	After 2013
Guarantees	$ 9.1	$ 5.0	$ 3.2	$	$ 0.1	$	$ 0.8
Standby letters of credit[(1)]							
Total	$ 9.1	$ 5.0	$ 3.2	$	$ 0.1	$	$ 0.8

(1) During the three months ended September 30, 2009, the Company funded $46.0 million in lieu of draws under standby letters of credit and the remaining standby letters of credit expired/terminated. At September 30, 2009, there were no standby letters of credit issued under the facility.

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 September 30, 2009, the Company had outstanding commitments to fund investments totaling $543.9 million, including $515.5 million related to private finance investments and $28.4 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. During October 2009, the Company sold its investment, including its outstanding commitments and the provision for management services, in the Senior Secured Loan Fund. See Note 14. Subsequent Events.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 6. Shareholders Equity

The Company did not sell any common stock during the nine months ended September 30, 2009. The Company sold 20.5 million shares of its common stock during the nine months ended September 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 0.7 million shares of common stock upon the exercise of stock options during the nine months ended September 30, 2009. No stock options were exercised during the nine months ended September 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 nine months ended September 30, 2009, the Company did not pay dividends and there was no activity in the dividend reinvestment plan. During the nine months ended September 30, 2008, under the dividend reinvestment plan the Company issued 0.2 million shares at an average price of $19.49 per share, and 0.5 million shares were purchased by a plan agent for shareholders at an average price of $14.43 per share.

Note 7. Earnings Per Common Share

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

(in millions, except per share amounts)	For the Three Months Ended September 30, 2009	For the Three Months Ended September 30, 2008	For the Nine Months Ended September 30, 2009	For the Nine Months Ended September 30, 2008
Net increase (decrease) in net assets resulting from operations	$ (140.7)	$ (318.3)	$ (517.4)	$ (461.2)
Weighted average common shares outstanding basic	179.1	178.7	178.8	171.1
Dilutive options outstanding				
Weighted average common shares outstanding diluted	179.1	178.7	178.8	171.1
Basic earnings (loss) per common share	$ (0.79)	$ (1.78)	$ (2.89)	$ (2.70)
Diluted earnings (loss) per common share	$ (0.79)	$ (1.78)	$ (2.89)	$ (2.70)

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 8. Employee Compensation Plans, continued

year) as long as the recipient remained employed by the Company. The Company currently has not established an IPA or IPB for 2009.

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.

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 nine months ended September 30, 2009 and 2008, were as follows:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
($ in millions)	**2009**	**2008**	**2009**	**2008**
IPA	$	$ 2.0	$	$ 6.6
IPA mark to market expense (benefit)				(4.1)
Total IPA expense	$	$ 2.0	$	$ 2.5
Total IPB expense	$	$ 2.4	$	$ 6.8

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 9. Stock Option Plan, continued

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 September 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 3.8 million and 9.5 million, respectively.

Information with respect to options granted, exercised and forfeited under the Option Plan for the nine months ended September 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 September 30, 2009[1]
Options outstanding at January 1, 2009	19.7	$ 26.56		
Granted	11.5	$ 0.88		
Exercised	(0.7)	$ 0.73		
Forfeited	(5.8)	$ 21.65		
Options outstanding at September 30, 2009	24.7	$ 16.48	5.10	$ 21.3
Exercisable at September 30, 2009[2]	15.2	$ 22.25	4.53	$ 6.8
Exercisable and expected to be exercisable at September 30, 2009[3]	23.3	$ 16.77	5.05	$ 19.7

(1) Represents the difference between the market value of the options at September 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 September 30, 2009, is calculated based on an estimate of expected forfeitures.

During the nine months ended September 30, 2008, 7.7 million options were granted, no options were exercised and 4.5 million options were forfeited. The fair value of the options vested during the nine months ended September 30, 2008 was $13.5 million.

Note 10. Dividends and Distributions and Taxes

At December 31, 2008, the Company met its dividend distribution requirements for the 2008 tax year and therefore did not have excess taxable income available for distribution to shareholders in 2009. The Company s Board of Directors has not declared any dividends in 2009. The Company s Board of Directors declared and the Company paid a dividend of $0.65 per common share for the first, second and third quarters of 2008, totaling $340.4 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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 10. Dividends and Distributions and Taxes, continued

nine months ended September 30, 2009. The Company recorded an excise tax of $0.9 million and $5.1 million for the three and nine months ended September 30, 2008, respectively.

In certain circumstances, the Company is restricted in its ability to pay dividends. Each of the Company s Notes and the Company s Facility contain provisions that limit the amount of dividends the Company can pay. In addition, pursuant to the 1940 Act, the Company may be 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 had cumulative deferred taxable income related to installment sale gains of approximately $218.9 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. 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 September 30, 2009 and 2008, AC Corp s income tax expense was $1.9 million and $1.2 million, respectively, and for the nine months ended September 30, 2009 and 2008, income tax expense was $4.2 million and $3.0 million, respectively. For the nine months ended September 30, 2009, paid in capital was decreased by $3.1 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 $140.8 million and $95.9 million, respectively, for the nine months ended September 30, 2009 and 2008. The Company paid income taxes, including excise taxes (net of refunds), of $5.5 million and $13.0 million the nine months ended September 30, 2009 and 2008, respectively.

Non-cash operating activities for the nine months ended September 30, 2009 and 2008, totaled $71.4 million and $107.7 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 nine months ended September 30, 2008.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 12. Financial Highlights

	At and for the Nine Months Ended September 30, 2009[1]	At and for the Nine Months Ended September 30, 2008	At and for the Year Ended December 31, 2008
Per Common Share Data			
Net asset value, beginning of period	$ 9.62	$ 17.54	$ 17.54
Net investment income[2]	0.31	1.04	1.23
Net realized gains (losses)[2][3]	(0.89)	0.28	(0.75)
Net investment income plus net realized gains (losses)[2]	(0.58)	1.32	0.48
Net change in unrealized appreciation (depreciation)[2][3]	(2.13)	(4.02)	(6.49)
Gain on repurchase of debt	0.47		
Loss on extinguishment of debt	(0.65)		
Net increase (decrease) in net assets resulting from operations[2]	(2.89)	(2.70)	(6.01)
Net decrease in net assets from shareholder distributions		(1.95)	(2.60)
Net increase (decrease) in net assets from capital share transactions[2]	(0.03)	0.62	0.69
Net asset value, end of period	$ 6.70	$ 13.51	$ 9.62
Market value, end of period	$ 3.07	$ 10.80	$ 2.69
Total return[4]	14.1%	(43.3)%	(82.5)%
Ratios and Supplemental Data			
($ and shares in millions, except per share amounts)			
Ending net assets	$ 1,201.3	$ 2,413.4	$ 1,718.4
Common shares outstanding at end of period	179.4	178.7	178.7
Diluted weighted average common shares outstanding	178.8	171.1	173.0
Employee, employee stock option and administrative expenses/average net assets[5]	4.32%	3.80%	5.47%
Total operating expenses/average net assets[5][6]	13.69%	7.85%	11.39%
Income tax expense (benefit), including excise tax/average net assets[5]	0.30%	0.30%	0.10%
Net investment income/average net assets[5]	3.93%	6.59%	8.47%
Net increase (decrease) in net assets resulting from operations/average net assets[5]	(36.76)%	(16.99)%	(41.34)%

Portfolio turnover rate(5)	4.12%	19.38%	24.00%
Average debt outstanding	$ 1,833.3	$ 2,072.8	$ 2,091.6
Average debt per share(2)	$ 10.25	$ 12.12	$ 12.09

(1) The results for the nine months ended September 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, if any, for the periods presented.

(5) The ratios for the nine months ended September 30, 2009 and 2008, do not represent annualized results.

(6) Includes 0.20% for the effect of the impairment of long-lived asset during the nine months ended September 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, during and following the two-year period of the order the Company has: (1) continued to employ a Chief Valuation Officer, or a similarly structured officer-level employee, to oversee its quarterly valuation processes; and (2) continued 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

As of November 6, 2009, the Company is aware of a putative class action and shareholder derivative complaint as well as an additional shareholder derivative complaint filed against the Company, its Board of Directors and Ares Capital Corporation. Both complaints allege that the Company s Board of Directors failed to discharge adequately its fiduciary duties to shareholders by failing to adequately value the Company s shares and ensure that its shareholders received adequate consideration in a proposed sale of Allied Capital to Ares Capital Corporation, that the proposed merger between the Company and Ares Capital is the product of a flawed sales process, that the Company s directors and officers breached their fiduciary duties by agreeing to a structure that was not designed to maximize the value of Allied s shares, and that Ares Capital aided and abetted the alleged breach of fiduciary duty. The plaintiffs demand, among other things, a preliminary and permanent injunction enjoining the sale and rescinding the transaction or any part thereof that has been implemented. The Company believes that each of the lawsuits is without merit, and it intends to defend each of these lawsuits vigorously.

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

In accordance with ASC Topic 855, the Company has evaluated events subsequent to September 30, 2009, and through the issuance of these consolidated financial statements, which occurred on November 6, 2009.

On October 26, 2009, the Company, entered into an Agreement and Plan of Merger (the Merger Agreement) with Ares Capital Corporation, a Maryland corporation (Ares Capital), and ARCC Odyssey Corp., a Maryland corporation and wholly-owned subsidiary of Ares Capital (Merger Sub). The Merger Agreement provides that, upon the terms and subject to the conditions set forth in the Merger Agreement, Merger Sub will merge with and into Allied Capital, with Allied Capital as the surviving company (the Merger). Immediately following the Merger, Allied Capital will merge with and into Ares Capital.

Upon consummation of the Merger, each share of common stock, par value $0.0001 per share, of Allied Capital issued and outstanding immediately prior to the effective time of the Merger will be converted into and become exchangeable for 0.325 common shares, par value $0.001 per share, of Ares Capital. Based on the number of shares of Allied Capital common stock outstanding on the date of the Merger Agreement and not including the effect of outstanding in-the-money options, this will result in approximately 58.3 million Ares Capital shares being exchanged for approximately 179.4 million outstanding Allied Capital shares, subject to adjustment in certain limited circumstances.

Following consummation of the transactions contemplated by the Merger Agreement, Ares Capital s Board of Directors will continue as directors of Ares Capital. However, Ares Capital s Board of Directors will be increased by at least one member and Ares Capital will submit the name of one member of

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 14. Subsequent Events, continued

Allied Capital s current Board of Directors for consideration to Ares Capital s Nominating and Governance Committee to fill the vacancy.

The Merger Agreement contains (a) customary representations and warranties of Allied Capital and Ares Capital, including, among others: corporate organization, capitalization, corporate authority and absence of conflicts, third party and governmental consents and approvals, reports and regulatory matters, financial statements, compliance with law and legal proceedings, absence of certain changes, taxes, employee matters, intellectual property, insurance, investment assets and certain contracts, (b) covenants of Allied Capital and Ares Capital to conduct their respective businesses in the ordinary course until the Merger is completed and (c) covenants of Allied Capital and Ares Capital not to take certain actions during this interim period.

Among other things, Allied Capital has agreed to, and will cause its affiliates, consolidated subsidiaries, and its and each of their respective officers, directors, managers, employees and other advisors, representatives and agents to, immediately cease and cause to be terminated all discussions and negotiations with respect to a Takeover Proposal (as defined in the Merger Agreement) from a third party and not to directly or indirectly solicit or take any other action (including providing information) with the intent to solicit any inquiry, proposal or offer with respect to a Takeover Proposal.

However, if Allied Capital receives a bona fide unsolicited Takeover Proposal from a third party, and its Board of Directors determines in good faith, after consultation with reputable outside legal counsel and financial advisers experienced in such matters, that failure to consider such proposal would breach the duties of the directors under applicable law, and the Takeover Proposal constitutes or is reasonably likely to result in a Superior Proposal (as defined in the Merger Agreement), Allied Capital may engage in discussions and negotiations with such third party so long as certain notice and other procedural requirements are satisfied. In addition, subject to certain procedural requirements (including the ability of Ares Capital to revise its offer) and the payment of a $30 million termination fee, Allied Capital may terminate the Merger Agreement and enter into an agreement with a third party who makes a Superior Proposal.

The representations and warranties of each party set forth in the Merger Agreement (a) have been qualified by confidential disclosures made to the other party in connection with the Merger Agreement, (b) will not survive consummation of the Merger and cannot be the basis for any claims under the Merger Agreement by the other party after the Merger is consummated, (c) are qualified in certain circumstances by a materiality standard which may differ from what may be viewed as material by investors, (d) were made only as of the date of the Merger Agreement or such other date as is specified in the Merger Agreement, and (e) may have been included in the Merger Agreement for the purpose of allocating risk between Allied Capital and Ares Capital rather than establishing matters as facts.

Consummation of the Merger, which is currently anticipated to occur by the end of the first quarter of 2010, is subject to certain conditions, including, among others, Allied Capital stockholder approval, Ares Capital stockholder approval, required regulatory approvals (including expiration of the waiting period under the Hart-Scott-Rodino Act), receipt of certain Ares Capital and Allied Capital lender consents and other customary closing conditions.

The Merger Agreement also contains certain termination rights for Allied Capital and Ares Capital and provides that, in connection with the termination of the Merger Agreement under specified circumstances, Allied Capital may be required to pay Ares Capital a termination fee of $30 million

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 14. Subsequent Events, continued

($15 million if Allied Capital stockholders do not approve the Merger) and Ares Capital may be required to pay Allied Capital a termination fee of $30 million.

In a separate transaction on October 30, 2009, the Company sold its interests, including its outstanding commitments and the provision of management services, in its Senior Secured Loan Fund LLC (the SL Fund, formerly known as the Unitranche Fund) to Ares Capital for $165 million in cash. At September 30, 2009, the SL Fund held unitranche loans totaling approximately $921 million. In addition, from September 30, 2009 through November 2, 2009, the Company has collected additional cash proceeds totaling approximately $30 million and has identified approximately $200 million of assets for potential future sale. The Company has also paid down an additional $94 million of private debt since September 30, 2009 and has cash and money market and other securities of $273 million as of November 2, 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 September 30, 2009, the related consolidated statements of operations for the three- and nine-month periods ended September 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 nine-month periods ended September 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.

Washington, D.C.
November 6, 2009

Schedule 12-14

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

SCHEDULE OF INVESTMENTS IN AND ADVANCES TO AFFILIATES

PRIVATE FINANCE Portfolio Company (in thousands)	**Investment[1]**	Amount of Interest or Dividends Credited to Income[6]	Other[2]	December 31, 2008 Value	Gross Additions[3]	Gross Reductions[4]	September 30, 2009 Value
Companies More Than 25% Owned							
AGILE Fund I, LLC (Private Equity Fund)	Equity Interests			$ 497	$ 34	$ (114)	$ 417
AllBridge Financial, LLC (Asset Management)	Senior Loan	$ 21			1,311		1,311
	Equity Interests			10,960	6,926	(2,363)	15,523
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			942		(38)	904
	Common Stock						
Avborne Heavy Maintenance, Inc. (Business Services)	Common Stock						
Aviation Properties Corporation (Business Services)	Common Stock						
Border Foods, Inc. (Consumer Products)	Senior Loan	4,162		33,027	2,637	(788)	34,876
	Preferred Stock			11,851	4,734		16,585
	Common Stock						
Calder Capital Partners, LLC (Asset Management)	Senior Loan[5]			953	147		1,100
	Equity Interests						
Callidus Capital Corporation (Asset Management)	Subordinated Debt	2,321		16,068	4,872	(5,775)	15,165
	Common Stock			34,377		(34,377)	

Ciena Capital LLC (Financial Services)	Senior Loan(5)			104,883		(2,651)	102,232
	Class B Equity Interests				3,504	(3,504)	
	Class C Equity Interests						
CitiPostal Inc. (Business Services)	Senior Loan	23		681	2		683
	Unitranche Debt	4,734		51,548	424	(971)	51,001
	Subordinated Debt	1,198		9,114	1,151		10,265
	Common Stock			8,616		(7,492)	1,124
Coverall North America, Inc. (Business Services)	Unitranche Debt	2,911		31,948	25	(408)	31,565
	Subordinated Debt	646		5,549	4		5,553
	Common Stock			17,968	3,293		21,261
CR Holding, Inc. (Consumer Products)	Subordinated Debt(5)			17,360	1,316	(8,405)	10,271
	Common Stock						
Crescent Equity Corp. (Business Services)	Senior Loan	33		433			433
	Subordinated Debt(5)	58	$ 166	18,614	83	(14,494)	4,203
	Common Stock			4,580	2,165	(6,745)	
Direct Capital Corporation (Financial Services)	Senior Loan(5)				8,573		8,573
	Subordinated Debt(5)			13,530		(6,391)	7,139
	Common Stock						
Financial Pacific Company (Financial Services)	Subordinated Debt	8,084		62,189	30	(20,802)	41,417
	Preferred Stock	10					
	Common Stock						
ForeSite Towers, LLC (Tower Leasing)	Equity Interest			889		(889)	
Global Communications, LLC (Business Services)	Senior Loan			1,335		(1,335)	
Hot Light Brands, Inc. (Retail)	Senior Loan(5)			13,678	50	(3,257)	10,471
	Common Stock						
Hot Stuff Foods, LLC (Consumer Products)	Senior Loan	1,526		42,378	11,219	(8,180)	45,417
	Subordinated Debt(5)				49,801		49,801
	Common Stock						
Huddle House, Inc. (Retail)	Subordinated Debt	4,918		57,067	962	(38,535)	19,494
	Common Stock			20,922		(13,271)	7,651

IAT Equity, LLC and Affiliates	Subordinated Debt	410	6,000		6,000
d/b/a Industrial Air Tool	Equity Interests		8,860	1,088	9,948
(Industrial Products)					

See related footnotes at the end of this schedule.

PRIVATE FINANCE Portfolio Company (in thousands)	**Investment[(1)]**	Amount of Interest or Dividends Credited to Income[(6)]	Other[(2)]	December 31, 2008 Value	Gross Additions[(3)]	Gross Reductions[(4)]	September 30, 2009 Value
Impact Innovations Group, LLC (Business Services)	Equity Interests in Affiliate			$ 321	$ 1	$	$ 322
Insight Pharmaceuticals Corporation (Consumer Products)	Subordinated Debt	$ 5,619		63,359	8,960	(20,221)	52,098
	Preferred Stock			4,068	20,932	(25,000)	
	Common Stock				34,088	(23,669)	10,419
Jakel, Inc. (Industrial Products)	Subordinated Debt[(5)]			374			374
Knightsbridge CLO 2007-1 Ltd. (CLO)	Class E Notes	1,442		14,866		(3,706)	11,160
	Income Notes	2,838		35,214	2,837	(15,411)	22,640
Knightsbridge CLO 2008-1 Ltd. (CLO)	Class C Notes	842		12,800		(554)	12,246
	Class D Notes	587		8,000		(920)	7,080
	Class E Notes	1,126		10,573	508	(1,283)	9,798
	Income Notes	2,924		21,315	2,924	(4,127)	20,112
MHF Logistical Solutions, Inc. (Business Services)	Subordinated Debt				49,633	(49,633)	
	Preferred Stock						
	Common Stock				20,942	(20,942)	
MVL Group, Inc. (Business Services)	Senior Loan	2,433		30,663	70	(5,477)	25,256
	Subordinated Debt	3,842		40,994	42,123	(47,096)	36,021
	Subordinated Debt[(5)]			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	(8,492)	13,870
Senior Secured Loan Fund LLC (Private Debt Fund)	Subordinated Certificates	11,782	$ 7,548	125,423	47,373	(7,796)	165,000
	Equity Interests			1		(1)	

Service Champ, Inc.	Subordinated Debt	3,235		26,984	531		27,515
(Business Services)	Common Stock			21,156	7,165		28,321
Stag-Parkway, Inc.	Subordinated Debt	1,362			19,001	(1)	19,000
(Business Services)	Unitranche Debt	170		17,962	418	(18,380)	
	Common Stock			6,968	391		7,359
Startec Equity, LLC	Equity Interests			332		(332)	
(Telecommunications)							
Worldwide Express	Subordinated Debt						
Operations, LLC			38	2,032	694	(2,726)	
(Business Services)	Equity Interests				11,384	(11,384)	
	Warrants				144	(144)	
Total companies more than 25% owned				**$ 1,187,722**			**$ 1,032,018**
Companies 5% to 25% Owned							
10th Street, LLC	Subordinated Debt	$ 2,148		$ 21,439	$ 676	$ (15)	