ALLIED CAPITAL CORP
Form 497
October 21, 2002

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Registration Statement No. 333-98441

# PROSPECTUS

## Non-Transferable Rights Offering to Purchase up to 5,250,000 Shares of Common Stock

We are granting at no cost to the holders of shares of our common stock subscription rights to purchase up to 5,250,000 shares of our common stock. The rights are non-transferable and will not be admitted for trading on the New York Stock Exchange. You will receive one right for every share of our common stock that you own as of the record date, which is October 21, 2002. For every 20 rights held you will be able to purchase one share of our common stock at the subscription price. Fractional shares will not be issued upon exercise of rights. As more fully described in this prospectus, you can also purchase shares of our common stock not acquired by other shareholders in this rights offering.

**The subscription price per share will be 93% of the average of the last reported sales price of a share of our common stock on the New York Stock Exchange on November 21, 2002, which we refer to as the pricing date, and the four preceding business days. Since the close of the rights offering on the expiration date will coincide with the pricing date, shareholders who choose to exercise their rights will not know the subscription price per share at the time they exercise such rights.** The offer will dilute the ownership interest and voting power of the common stock owned by shareholders who do not fully exercise their basic subscription rights. Shareholders who do not fully exercise their basic subscription rights should expect, upon completion of the rights offering, to own a smaller proportional interest in us than before the rights offering.

**The rights will expire if they are not exercised by 5:00 p.m., New York City time, on November 21, 2002, the expiration date of the rights offering unless extended. We, in our sole discretion, may extend the period for exercising the rights. You will have no right to rescind your subscriptions after receipt of your payment of the estimated subscription price except as described in this prospectus.**

Please read this prospectus before investing, and keep it for future reference. It contains important information about us. The SEC maintains an Internet website (http://www.sec.gov) that contains other information about us.

We are an internally managed closed-end management investment company that has elected to be regulated as a business development company under the Investment Company Act of 1940. Our investment objective is to achieve current income and capital gains. We seek to achieve our investment objective by investing primarily in private companies in a variety of industries throughout the United States. No assurances can be given that we will continue to achieve our objective. Our common stock is traded on the New York Stock Exchange under the symbol ALD. As of October 18, 2002, the last reported sale price on the New York Stock Exchange for our common stock was $21.87.

| | Per Share | Total |
|---|---|---|
| Estimated Subscription Price(1) | $20.34 | $106,785,000 |
| Sales Load | None | None |
| Proceeds to the Company(2)(3) | $20.34 | $106,785,000 |

(1) Estimated, using 93% of the average of the last reported sales price of a share of our common stock on the NYSE on October 18, 2002.

(2) Before deduction of expenses incurred by us related to this rights offering estimated to be $750,000.

(3) The proceeds that we will receive in this rights offering assumes that all 5,250,000 shares are purchased at this estimated subscription price.

**You should review the information, including the risk of leverage, set forth under Risk Factors on page 12 of this prospectus before investing in our common stock.**

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

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October 21, 2002

**We have not authorized any dealer, salesman or other person to give any information or to make any representation other than those contained in this prospectus. You must not rely upon any information or representation not contained in this prospectus as if we had authorized it. This prospectus does not constitute an offer to sell or a solicitation of any offer to buy any security other than the registered securities to which it relates, nor does it constitute an offer to sell or a solicitation of an offer to buy any securities in any jurisdiction to any person to whom it is unlawful to make such an offer or solicitation in such jurisdiction. The information contained in this prospectus is accurate as of the date of this prospectus.**

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## PROSPECTUS SUMMARY

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

*In this prospectus, unless otherwise indicated, Allied Capital, we, us or our refer to Allied Capital Corporation and its subsidiaries.*

### BUSINESS *(Page 69)*

We are a business development company that participates in the private equity market. We generally invest in illiquid securities through privately negotiated transactions. We provide long-term debt and equity investment capital to support the expansion of primarily private companies in a variety of industries. We have been investing in businesses for over 40 years and have financed thousands of companies nationwide. Our investment activity is generally focused in two areas:

- private finance, and
- commercial real estate finance, primarily in non-investment grade commercial mortgage-backed securities.

Our investment portfolio generally includes:

- long-term unsecured loans with or without equity features known as mezzanine financing,
- equity investments in companies, which may or may not constitute a controlling equity interest,
- non-investment grade commercial mortgage-backed securities, and
- commercial mortgage loans.

We identify loans and investments through our numerous relationships with:

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

Our credit and investment approval process is centralized at our headquarters in Washington, DC.

Our tax structure generally allows us to pass-through our income to our shareholders through dividends without the imposition of a corporate level of taxation, if certain requirements are met. See Tax Status.

We are an internally managed diversified closed-end management investment company that has elected to be regulated as a business development company under the Investment Company Act of 1940, which we refer to as the 1940 Act. Our investment objective is to achieve current income and capital gains. We seek to achieve our investment objective by investing primarily in private businesses in a variety of industries throughout the United States.

As a business development company, we are required to meet certain regulatory tests, the most significant relating to our investments and borrowings. A business development

1

company is required to invest at least 70% of its assets in eligible portfolio companies, which includes private or thinly traded public, U.S.-based entities. A business development company must also maintain a coverage ratio of assets to senior securities of at least 200%. See Certain Government Regulations.

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

Our Internet website address is *www.alliedcapital.com.* Information contained on our website is not incorporated by reference into this prospectus and you should not consider information contained on our website to be part of this prospectus.

Our common stock is traded on the New York Stock Exchange under the symbol ALD.

During the third quarter ended September 30, 2002, private finance new investment activity totaled approximately $148 million, including loans, debt securities, and equity interests.

**VALUATION OF PORTFOLIO INVESTMENTS** *(Page 91)*

Our portfolio investments are generally recorded at fair value as determined in good faith by our board of directors in absence of readily ascertainable public market values.

At June 30, 2002, approximately 93% of our total assets represented investments recorded at fair value. Pursuant to the requirements of the 1940 Act, we value substantially all of our investments at fair value as determined in good faith by our board of directors on a quarterly basis. Since there is typically no readily ascertainable market value for the investments in our portfolio, our board of directors determines in good faith the fair value of these investments pursuant to a valuation policy and a consistently applied valuation process.

There is no single standard for determining fair value in good faith. As a result, determining fair value requires that judgment be applied to the specific facts and circumstances of each portfolio investment while employing a consistently applied valuation process for the types of investments we make. Unlike banks, we are not permitted to provide a general reserve for anticipated loan losses; we are instead required by the 1940 Act to specifically value each individual investment and record unrealized depreciation for an investment that we believe has become impaired including where collection of a loan or realization of an equity security is doubtful. Conversely, we will record unrealized appreciation if we have an indication that the underlying portfolio company has appreciated in value and, therefore, our equity security has also appreciated in value, where appropriate. Without a readily ascertainable market value and because of the inherent uncertainty of valuation, the fair value of our investments determined in good faith by the board of directors may differ significantly from the values that would have been used had a ready market existed for the investments, and the differences could be material.

We adjust quarterly the valuation of our portfolio to reflect the board of directors determination of the fair value of each investment in our portfolio. Any changes in fair value are recorded in our statement of operations as Net unrealized gains (losses).

**THE RIGHTS OFFERING** *(Page 19)*

| | |
|---|---|
| Rights | We will distribute to each holder of our common stock one non-transferable right to purchase our common stock for each share of our common stock owned by such holder on the record date, which is October 21, 2002. Fractional shares will not be issued upon exercise of rights. |
| Basic Subscription Rights | The basic subscription rights entitle you to purchase one share of our common stock at the subscription price for every 20 rights you hold. You are entitled to subscribe for all or any portion of the shares of our common stock underlying your basic subscription rights. |
| Over-Subscription Right | If you elect to exercise all of your rights to purchase our common stock pursuant to your basic subscription rights, you will also have an over- subscription right to subscribe for additional shares of our common stock, if any, that are not purchased by other holders of rights pursuant to their basic subscription rights as of the expiration date. |
| Proration of Over-Subscription Right | If there are shares of our common stock available for sale pursuant to the exercise of the over-subscription right and the number of shares is not sufficient to satisfy in full all subscriptions submitted for additional shares, we will allocate the available shares pro rata among holders who exercise their over-subscription right in proportion to the number of shares each subscriber for additional shares has elected to purchase under their basic subscription rights. |
| Subscription Price | The subscription price per share will be 93% of the average of the last reported sales price of a share of our common stock on the NYSE on November 21, 2002, which we refer to as the pricing date, and the four preceding business days. |
| Estimated Subscription Price | The estimated subscription price is $20.34 per share. Because it is not possible to determine the subscription price until the pricing date, shareholders exercising their subscription rights will not know the subscription price per share at the time they exercise their rights. As a result, we are requiring that shareholders deliver the estimated subscription price in connection with the exercise of their basic subscription rights and, if applicable, their over-subscription right. If the actual subscription price is lower, excess payments will be refunded (without interest), and if the actual subscription price is higher, shareholders exercising their rights must make an additional payment by December 20, 2002. |
| Expiration Date | November 21, 2002, at 5:00 p.m., New York City time, unless we decide to extend it to some later time. |

| | |
|---|---|
| Procedure for Exercising Subscription Rights | If you wish to exercise any or all of your subscription rights, you should properly complete, sign and deliver your subscription certificate together with full payment of the estimated subscription price for each share subscribed for under your subscription rights (including shares subscribed for through the exercise of your over-subscription right), to the subscription agent on or prior to the expiration date. You may not revoke an exercise of rights. |
| How Rights Holders Can Exercise Rights Through Brokers, Banks or Other Nominees | If you hold shares of our common stock through a broker, bank or other nominee, we will ask your broker, bank or other nominee to notify you of the rights offering. If you wish to exercise your rights, you will need to have your broker, bank or other nominee act for you. To indicate your decision, you should complete and return to your broker, bank or other nominee the form entitled Beneficial Owner Election Form, together with full payment of the estimated subscription price for each share subscribed for under your subscription rights (including shares subscribed for through the exercise of your over-subscription right). You should receive this form from your broker, bank or other nominee with the other rights offering materials. |
| Amendments; Termination | We reserve the right to amend the terms and conditions of this rights offering or to terminate this rights offering prior to delivery of the common stock. |
| Non-Transferability of Rights | Subscription rights are being issued only to holders of our common stock as of the record date and are non-transferable. Therefore, only the underlying shares of common stock, and not the rights, will be admitted for trading on the NYSE. |
| Issuance of Our Common Stock | Unless requested otherwise, stock certificates will not be issued for shares of our common stock offered in this rights offering. Shareholders who are record owners will have the shares they acquire credited to their account with our transfer agent. All future dividends paid on such shares will be paid either in cash or reinvested in additional shares, depending on the election you made in connection with our dividend reinvestment plan. Shareholders whose common stock are held by a nominee will have the shares they acquire credited to the account of such nominee holder. |
| Dilutive Effects | This rights offering will dilute the ownership interest and voting power of shareholders who do not fully exercise their basic subscription rights. |

## INFORMATION AGENT

The information agent for the rights offering is:

Georgeson Shareholder Communications, Inc.

Toll-free: (866) 206-4938

Shareholders may also call us toll-free at (888) 818-5298 or contact their brokers, banks or other nominees for information with respect to the rights offering.

## IMPORTANT DATES TO REMEMBER

| Event | Date |
| --- | --- |
| Record date | October 21, 2002 |
| Subscription Period | |
| October 21, 2002 to November 21, 2002* | |
| Expiration Date and Pricing Date | |
| November 21, 2002* | |
| Subscription Certificates and Payment for Shares Due | |
| November 21, 2002* | |
| Notice of Guaranteed Delivery Due | |
| November 21, 2002* | |
| Subscription Certificates for Guarantees of Delivery Due | |
| November 26, 2002* | |
| Confirmation to Participants | |
| December 6, 2002* | |
| Final Payment for Shares | |
| December 20, 2002* | |

* Unless the rights offering is extended.

Shareholders exercising rights must deliver to the subscription agent by the expiration date either (i) the subscription certificate together with payment or (ii) a notice of guaranteed delivery together with payment.

**USE OF PROCEEDS** *(Page 29)*

Assuming the full exercise of the rights, the cash proceeds from the sale of the shares of our common stock will be approximately $106,785,000, before payment of offering fees and expenses. We intend to use the net proceeds from the rights offering for investments in the debt or equity securities of primarily private companies or non-investment grade commercial mortgage-backed securities, and other general corporate purposes.

**DISTRIBUTIONS** *(Page 30)*

We intend to pay quarterly dividends to holders of our common stock. The amount of our quarterly dividends is determined by our board of directors.

Because we anticipate that the rights offering will be completed by no later than December 20, 2002, we expect that shares of our common stock acquired in the rights offering will be of record for the fourth quarter dividend of 2002 and, therefore, holders of such shares will be entitled to any dividend declared by us in the fourth quarter of 2002.

**DIVIDEND REINVESTMENT PLAN** *(Page 116)*

We maintain a dividend reinvestment plan for our common shareholders. Effective May 1, 2002, we converted from an opt out to an opt in dividend reinvestment plan. As a result, if our board of directors declares a dividend, then our new shareholders that have not opted in to our dividend reinvestment plan will receive cash dividends. New shareholders must notify our transfer agent in writing if they wish to enroll in the dividend reinvestment plan. Existing dividend reinvestment plan accounts will not be affected by this amendment.

**RISK FACTORS** *(Page 12)*

Investment in our common stock involves certain risks relating to our business and our investment objective that you should consider before purchasing our common stock.

As a business development company, our portfolio includes securities primarily issued by privately held companies. These investments may involve a high degree of business and financial risk; they are illiquid, and may not produce current returns or capital gains. If we were forced to immediately liquidate some or all of the investments in the portfolio, the proceeds of such liquidation would be significantly less than the current value of such investments.

An economic slowdown may affect the ability of a portfolio company to engage in a liquidity event. These conditions could lead to financial losses in our portfolio and a decrease in our revenues, net income and assets. Numerous other factors may affect a borrower s ability to repay its loan, including the failure to meet its business plan, a downturn in its industry or negative economic conditions.

We may not borrow money unless we maintain asset coverage for indebtedness of at least 200% which may affect returns to shareholders. We borrow funds to make investments. As a result, we are exposed to the risks of leverage, which may be considered a speculative investment technique. Borrowings, also known as leverage, magnify the potential for gain and loss on amounts invested and therefore increase the risks associated with investing in our securities.

A large number of entities and individuals compete for the same kind of investment opportunities as we do. Our business of making private equity investments may be affected by current and future market conditions. The absence of an active senior lending environment may slow the amount of private equity investment activity generally. As a result, the pace of our investment activity may slow.

We may not be able to pay dividends and the loss of pass-through tax treatment could have a material adverse effect on our total return, if any.

Also, we are subject to certain risks associated with valuing our portfolio, investing in non-investment grade commercial mortgage-backed securities, changing interest rates, accessing additional capital, fluctuating financial results, and operating in a regulated environment.

Our common stock price may be volatile due to market factors that may be beyond our control.

**CERTAIN ANTI-TAKEOVER PROVISIONS** *(Page 118)*

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

**LEGAL PROCEEDINGS** *(Page 82)*

A series of class action lawsuits have been filed in the United States District Court for the Southern District of New York against us, certain of our directors and officers and our former independent auditors, Arthur Andersen LLP, with respect to alleged violations of the securities laws. These lawsuits allege violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder, specifically they allege, among other things, that we purportedly misstated the value of certain portfolio investments in our financial statements, which allegedly resulted in the purchase of our common stock by purported class members at artificially inflated prices. Several of the complaints also allege state law claims for common law fraud. The complaints seek compensatory and other damages, and costs and expenses associated with the litigation. The lawsuits have been consolidated into a single proceeding captioned In re Allied Capital Corp. Securities Litigation, 02 CV 3812. We believe that the lawsuit is without merit, and we intend to defend the lawsuit vigorously. While we do not expect these matters to materially affect our financial condition or results of operations, there can be no assurance as to whether any such pending litigation will have a material adverse effect on our financial condition or results of operations in any future reporting period.

## FEES AND EXPENSES

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

| | |
|---|---|
| **Shareholder Transaction Expenses** | |
| Sales load | None |
| Dividend reinvestment plan fees(1) | None |
| **Annual Expenses (as a percentage of consolidated net assets attributable to common stock)**(2) | |
| Operating expenses(3) | 3.6% |
| Interest payments on borrowed funds(4) | 5.1% |
| Total annual expenses(5) | 8.7% |

(1) The expenses of our dividend reinvestment plan are included in Operating expenses. We have no cash purchase plan. The participants in the dividend reinvestment plan will bear a pro rata share of brokerage commissions incurred with respect to open market purchases or sales, if any. See Dividend Reinvestment Plan.

(2) Consolidated net assets attributable to common stock equals net assets (*i.e.*, total consolidated assets less total consolidated liabilities and preferred stock) at June 30, 2002.

(3) Operating expenses represent our estimated operating expenses for the year ending December 31, 2002 excluding interest on indebtedness. This percentage for the year ended December 31, 2001 was 3.8%.

(4) The Interest payments on borrowed funds represents our estimated interest expenses for the year ending December 31, 2002. We had outstanding borrowings of $1,009.0 million at June 30, 2002. This percentage for the year ended December 31, 2001 was 5.5%. See Risk Factors.

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

### Example

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

| | 1 Year | 3 Years | 5 Years | 10 Years |
|---|---|---|---|---|
| You would pay the following expenses on a $1,000 investment, assuming a 5.0% annual return | $87 | $261 | $436 | $876 |

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

**The example should not be considered a representation of future expenses, and the actual expenses**

**may be greater or less than those shown.**

## SELECTED CONDENSED CONSOLIDATED FINANCIAL DATA

You should read the condensed consolidated financial information below with the Consolidated Financial Statements and Notes thereto included in this prospectus. Financial information for the years ended December 31, 2001, 2000, 1999, 1998 and 1997 has been derived from our financial statements that were audited by Arthur Andersen LLP. For important information about Arthur Andersen LLP, see the section entitled Notice Regarding Arthur Andersen LLP. Quarterly financial information is derived from unaudited financial data, but in the opinion of management, reflects all adjustments (consisting only of normal recurring adjustments) which are necessary to present fairly the results for such interim periods. Interim results at and for the six months ended June 30, 2002 are not necessarily indicative of the results that may be expected for the year ending December 31, 2002. **See Management s Discussion and Analysis of Financial Condition and Results of Operations on page 32 for more information.**

| (in thousands, except per share data) | Six Months Ended June 30, 2002 | 2001 | Year Ended December 31, 2001 | 2000 | 1999 | 1998 | 1997 |
|---|---|---|---|---|---|---|---|
| | (unaudited) | | | | | | |
| **Operating Data:** | | | | | | | |
| Interest and related portfolio income: | | | | | | | |
| Interest and dividends | $127,665 | $113,699 | $240,464 | $182,307 | $121,112 | $80,281 | $86,882 |
| Premiums from loan dispositions | 1,659 | 1,731 | 2,504 | 16,138 | 14,284 | 5,949 | 7,277 |
| Post-merger gain on securitization of commercial mortgage loans | | | | | | 14,812 | |
| Fees and other income | 26,260 | 18,380 | 46,142 | 13,144 | 5,744 | 5,696 | 3,246 |
| Total interest and related portfolio income | 155,584 | 133,810 | 289,110 | 211,589 | 141,140 | 106,738 | 97,405 |

Expenses:

Interest
34,984 31,881 65,104 57,412 34,860 20,694 26,952
Employee
16,309 14,056 29,656 26,025 22,889 18,878 10,258
Administrative
7,861 6,027 15,299 15,435 12,350 11,921 8,970
Merger
5,159

Total operating expenses
59,154 51,964 110,059 98,872 70,099 51,493 51,339

Net investment income before income tax benefit (expense) and net realized and unrealized gains
96,430 81,846 179,051 112,717 71,041 55,245 46,066
Income tax benefit (expense)
412 (787) (1,444)

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Net investment income before net realized and unrealized gains | 96,430 | 81,846 | 179,463 | 112,717 | 71,041 | 54,458 | 44,622 |
| Net realized and unrealized gains: | | | | | | | |
| Net realized gains | 8,850 | 4,991 | 661 | 15,523 | 25,391 | 22,541 | 10,704 |
| Net unrealized gains | 24,135 | 11,297 | 20,603 | 14,861 | 2,138 | 1,079 | 7,209 |
| Total net realized and unrealized gains | 32,985 | 16,288 | 21,264 | 30,384 | 27,529 | 23,620 | 17,913 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Income before minority interests | 129,415 | 98,134 | 200,727 | 143,101 | 98,570 | 78,078 | 62,535 |
| Minority interests | | | | | | | 1,231 |
| Net increase in net assets resulting from operations | $129,415 | $98,134 | $200,727 | $143,101 | $98,570 | $78,078 | $61,304 |

**Per Share:**

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Diluted earnings per common share | $1.26 | $1.10 | $2.16 | $1.94 | $1.64 | $1.50 | $1.24 |
| Dividends per common share(1) | $1.08 | $0.99 | $2.01 | $1.82 | $1.60 | $1.43 | $1.20 |
| Weighted average common shares outstanding diluted(2) | 102,900 | 88,966 | 93,003 | 73,472 | 60,044 | 51,974 | 49,251 |

| (in thousands, except per share data) | At June 30, | At December 31, | | | | |
|---|---|---|---|---|---|---|
| | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 |
| | (unaudited) | | | | | |
| **Balance Sheet Data:** | | | | | | |
| Portfolio at value | $2,380,969 | $2,329,590 | $1,788,001 | $1,228,497 | $807,119 | $703,331 |
| Portfolio at cost | 2,305,252 | 2,286,602 | 1,765,895 | 1,222,901 | 803,479 | 697,030 |
| Total assets | 2,568,616 | 2,460,713 | 1,853,817 | 1,290,038 | 856,079 | 807,775 |
| Total debt outstanding(3) | 1,008,950 | 1,020,806 | 786,648 | 592,850 | 334,350 | 347,663 |
| Preferred stock issued to Small Business Administration(3) | 7,000 | 7,000 | 7,000 | 7,000 | 7,000 | 7,000 |
| Shareholders equity | 1,434,453 | 1,352,123 | 1,029,692 | 667,513 | 491,358 | 420,060 |
| Shareholders equity per common share (net asset value) | $14.02 | $13.57 | $12.11 | $10.20 | $8.79 | $8.07 |
| Common shares outstanding at period end(2) | 102,296 | 99,607 | 85,057 | 65,414 | 55,919 | 52,047 |

| | Six Months Ended June 30, | | Year Ended December 31, | | | | |
|---|---|---|---|---|---|---|---|
| | 2002 | 2001 | 2001 | 2000 | 1999 | 1998 | 1997 |
| | (unaudited) | | | | | | |
| **Other Data:** | | | | | | | |
| Investments funded | $195,455 | $299,843 | $680,329 | $901,545 | $751,871 | $524,530 | $364,942 |
| Repayments | 67,017 | 42,544 | 74,461 | 111,031 | 139,561 | 138,081 | 233,005 |
| Sales | 126,280 | 74,648 | 129,980 | 280,244 | 198,368 | 81,013 | 53,912 |
| Realized gains | 15,429 | 6,596 | 10,107 | 28,604 | 31,536 | 25,757 | 15,804 |
| Realized losses | (6,579) | (1,605) | (9,446) | (13,081) | (6,145) | (3,216) | (5,100) |
| Return on average assets(4) | | | 9.4% | 9.1% | 9.2% | 10.1% | 7.9% |
| Return on average equity(4) | | | 17.0% | 17.2% | 17.5% | 18.0% | 14.8% |

(1) Distributions are based on taxable income, which differs from income for financial reporting purposes. Dividends for 1997 exclude certain merger-related dividends of $0.51 per common share.

(2) Excludes 234,977, 516,779 and 810,456 common shares held in the deferred compensation trust at and for the years ended December 31, 2000, 1999, and 1998, respectively.

(3) See Senior Securities on page 65 for more information regarding our level of indebtedness.

(4) Return on average assets and return on average equity are only presented on an annual basis as interim period calculations may not be meaningful due to quarterly fluctuations in net increase in net assets from operations.

| **(in thousands, except per share data)** | **2002** | | **2001** | | | | **2000** | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **Qtr 2** | **Qtr 1** | **Qtr 4** | **Qtr 3** | **Qtr 2** | **Qtr 1** | **Qtr 4** | **Qtr 3** | **Qtr 2** | **Qtr 1** |
| **Quarterly Data (unaudited):** | | | | | | | | | | |
| Total interest and related portfolio income | $73,193 | $82,391 | $82,666 | $72,634 | $68,739 | $65,071 | $61,735 | $55,992 | $49,965 | $43,897 |
| Net investment income before net realized and unrealized gains | 42,561 | 53,869 | 53,016 | 44,189 | 42,118 | 39,728 | 34,725 | 30,719 | 24,700 | 22,573 |
| Net increase in net assets resulting from operations | 73,454 | 55,961 | 42,890 | 59,703 | 46,106 | 52,028 | 42,281 | 36,449 | 34,790 | 29,581 |
| Diluted earnings per common share | 0.71 | 0.55 | 0.43 | 0.63 | 0.51 | 0.60 | 0.52 | 0.48 | 0.50 | 0.45 |
| Dividends declared per common share | 0.55 | 0.53 | 0.51 | 0.51 | 0.50 | 0.49 | 0.46 | 0.46 | 0.45 | 0.45 |
| Net asset value per common share(1) | 14.02 | 13.71 | 13.57 | 13.42 | 12.79 | 12.26 | 12.11 | 11.56 | 10.96 | 10.44 |

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

## WHERE YOU CAN FIND

## ADDITIONAL INFORMATION

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

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

## RISK FACTORS

*Investing in Allied Capital involves a number of significant risks relating to our business and investment objective. As a result, there can be no assurance that we will achieve our investment objective. In addition to the other information contained in this prospectus, you should consider carefully the following information before making an investment in our common stock.*

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

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

**Substantially all of our portfolio investments are recorded at fair value as determined in good faith by our board of directors and, as a result, there is uncertainty regarding the value of our portfolio investments.** At June 30, 2002, approximately 93% of our total assets represented investments recorded at fair value. Pursuant to the requirements of the 1940 Act, we value substantially all of our investments at fair value as determined in good faith by our board of directors on a quarterly basis. Since there is typically no readily ascertainable market value for the investments in our portfolio, our board of directors determines in good faith the fair value of these investments pursuant to a valuation policy and a consistently applied valuation process.

There is no single standard for determining fair value in good faith. As a result, determining fair value requires that judgment be applied to the specific facts and circumstances of each portfolio investment while employing a consistently applied valuation process for the types of investments we make. Unlike banks, we are not permitted to provide a general reserve for anticipated loan losses; we are instead required by the 1940 Act to specifically value each individual investment and record unrealized depreciation for an investment that we believe has become impaired, including where collection of a loan or realization of an equity security is doubtful. Conversely, we will record unrealized appreciation if we have an indication that the underlying portfolio company has appreciated in value and, therefore, our security has also appreciated in value, where appropriate. Without a readily ascertainable market value and because of the inherent uncertainty of valuation, fair value of our investments determined in good faith by the board of directors may differ significantly from the values that would have been used had a ready market existed for the investments, and the differences could be material.

We adjust quarterly the valuation of our portfolio to reflect the board of directors determination of the fair value of each investment in our portfolio. Any changes in fair value are recorded in our statement of operations as Net unrealized gains (losses).

**Economic recessions or downturns could impair our portfolio companies and harm our operating results.** Many of the companies in which we have made or will make investments may be susceptible to economic slowdowns or recessions. An economic slowdown may affect the ability of a company to engage in a liquidity event. Our non-performing assets are likely to increase and the value of our portfolio is likely to decrease during these periods. These conditions could lead to financial losses in our portfolio and a decrease in our revenues, net income and assets.

Our business of making private equity investments and positioning them for liquidity events also may be affected by current and future market conditions. The absence of an active senior lending environment may slow the amount of private equity investment activity generally. As a result, the pace of our investment activity may slow. In addition, significant changes in the capital markets could have an effect on the valuations of private companies and on the potential for liquidity events involving such companies. This could affect the amount and timing of gains realized on our investments.

**Our borrowers may default on their payments, which may have an effect on our financial performance.** We make long-term unsecured, subordinated loans and invest in equity securities, which may involve a higher degree of repayment risk. We primarily invest in companies that may have limited financial resources and that may be unable to obtain financing from traditional sources. Numerous factors may affect a borrower s ability to repay its loan, including the failure to meet its business plan, a downturn in its industry or negative economic conditions. Deterioration in a borrower s financial condition and prospects may be accompanied by deterioration in any related collateral.

**Our private finance investments may not produce current returns or capital gains.** Private finance investments are typically structured as debt securities with a relatively high fixed rate of interest and with equity features such as conversion rights, warrants or options. As a result, private finance investments are generally structured to generate interest income from the time they are made, and may also produce a realized gain from an accompanying equity feature. We cannot be sure that our portfolio will generate a current return or capital gains.

**Our financial results could be negatively affected if Business Loan Express fails to perform as expected.** Business Loan Express, Inc. is our largest portfolio investment. Our financial results could be negatively affected if Business Loan Express, as a portfolio company, fails to perform as expected or if government funding for, or regulations related to the Small Business Administration 7(a) Guaranteed Loan Program change. At June 30, 2002, the investment totaled $251.9 million at value, or 9.8% of total assets.

In addition, as controlling shareholder of Business Loan Express, we have provided an unconditional guaranty to Business Loan Express senior credit facility lenders in an amount equal to 50% of Business Loan Express total obligations on its $124.0 million revolving credit facility. The amount we have guaranteed at June 30, 2002, was $48.1 million. This guaranty can only be called in the event of a default by Business Loan Express. We have also provided two standby letters of credit in connection with two term loan securitization transactions completed by Business Loan Express in the second quarter of 2002 totaling $10.6 million.

**Investments in non-investment grade commercial mortgage-backed securities may be illiquid, may have a higher risk of default and may not produce current returns.** The commercial mortgage-backed securities in which we invest are not investment grade, which means that nationally recognized statistical rating organizations rate them below the top four investment-grade rating categories (i.e., AAA through BBB ), and are sometimes referred to as junk bonds. Non-investment grade commercial mortgage-backed securities tend to be less liquid, may have a higher risk of default and may be more difficult to value. Non-investment grade securities usually provide a higher yield than do investment-grade securities, but with the higher return comes greater risk of default. Economic recessions or downturns may cause defaults or losses on collateral securing these securities to increase. Non-investment grade securities are considered speculative, and their capacity to pay principal and interest in accordance with the terms of their issue is not ensured.

**We may not borrow money unless we maintain asset coverage for indebtedness of at least 200% which may affect returns to shareholders.** We must maintain asset coverage for total borrowings of at least 200%. Our ability to achieve our investment objective may depend in part on our continued ability to maintain a leveraged capital structure by borrowing from banks or other lenders on favorable terms. There can be no assurance that we will be able to maintain such leverage. If asset coverage declines to less than 200%, we may be required to sell a portion of our investments when it is disadvantageous to do so. As of June 30, 2002, our asset coverage for senior indebtedness was 256%.

**We borrow money which magnifies the potential for gain or loss on amounts invested and may increase the risk of investing in us.** Borrowings, also known as leverage, magnify the potential for gain or loss on amounts invested and, therefore, increase the risks associated with investing in our securities. We borrow from, and issue senior debt securities to, banks, insurance companies and other lenders. Lenders of these senior securities have fixed dollar claims on our consolidated assets that are superior to the claims of our common shareholders. If the value of our consolidated assets increases, then leveraging would cause the net asset value attributable to our common stock to increase more sharply than it would have had we not leveraged. Conversely, if the value of our consolidated assets decreases, leveraging would cause net asset value to decline more sharply than it otherwise would have had we not leveraged. Similarly, any increase in our consolidated income in excess of consolidated interest payable on the borrowed funds would cause our net income to increase more than it would without the leverage, while any decrease in our consolidated income would cause net income to decline more sharply than it would have had we not borrowed. Such a decline could negatively affect our ability to make common stock dividend payments. Leverage is generally considered a speculative investment technique.

At June 30, 2002, we had $1,009.0 million of outstanding indebtedness, bearing a weighted average annual interest cost of 7.2%. In order for us to cover these annual interest payments on indebtedness, we must achieve annual returns on our assets of at least 2.8%.

*Illustration.* The following table illustrates the effect of leverage on returns from an investment in our common stock assuming various annual returns, net of expenses. The calculations in the table below are hypothetical and actual returns may be higher or lower than those appearing below. The calculation assumes (i) $2,568.6 million in total assets, (ii) an average cost of funds of 7.2%, (iii) $1,009.0 million in debt outstanding and (iv) $1,434.5 million of shareholders equity.

| | Assumed Return on Our Portfolio (net of expenses) | | | | | | |
|---|---|---|---|---|---|---|---|
| | **-20%** | **-10%** | **-5%** | **0%** | **5%** | **10%** | **20%** |
| Corresponding return to shareholder | -40.8% | -23.0% | -14.0% | -5.1% | 3.9% | 12.8% | 30.7% |

**Changes in interest rates may affect our cost of capital and net investment income.** Because we borrow money to make investments, our net investment income before net realized and unrealized gains or losses, or net investment income, is dependent upon the difference between the rate at which we borrow funds and the rate at which we invest these funds. As a result, there can be no assurance that a significant change in market interest rates will not have a material adverse effect on our net investment income. In periods of sharply rising interest rates, our cost of funds would increase, which would reduce our net investment income. We use a combination of long-term and short-term borrowings and equity capital to finance our investing activities. We utilize our short-term credit facilities as a means to bridge to long-term financing. Our long-term fixed-rate investments are financed primarily with long-term fixed-rate debt and equity. We may use interest rate risk management techniques in an effort to limit our exposure to interest rate fluctuations. Such techniques may include various interest rate hedging activities to the extent permitted by the 1940 Act. We have analyzed the potential impact of changes in interest rates on interest income net of interest expense. Assuming that the balance sheet were to remain constant and no actions were taken to alter the existing interest rate sensitivity, a hypothetical immediate 1% change in interest rates would have affected the net increase in net assets resulting from operations, or net income, by less than 1% over a one year horizon. Although management believes that this measure is indicative of our sensitivity to interest rate changes, it does not adjust for potential changes in credit quality, size and composition of the assets on the balance sheet and other business developments that could affect net increase in assets resulting from operations, or net income. Accordingly, no assurances can be given that actual results would not differ materially from the potential outcome simulated by this estimate.

**We will continue to need additional capital to grow because we must distribute our income.** We will continue to need capital to fund incremental growth in our investments. Historically, we have borrowed from financial institutions and have issued equity securities. A reduction in the availability of new capital could limit our ability to grow. We must distribute at least 90% of our taxable ordinary income, which excludes net realized long-term capital gains, to our shareholders to maintain our regulated investment company status. As a result, such earnings will not be available to fund investment originations. We expect to continue to borrow from financial institutions and sell additional equity securities. If we fail to obtain funds from such sources or from other sources to fund our investments, it could limit our ability to grow, which could have a material adverse effect on the value of our common stock. In addition, as a business development company, we are generally required to maintain a ratio of at least 200% of total assets to total borrowings, which may restrict our ability to borrow in certain circumstances.

**Loss of pass-through tax treatment would substantially reduce net assets and income available for dividends.** We have operated so as to qualify as a regulated investment company under Subchapter M of the Internal Revenue Code of 1986. If we meet source of income, diversification and distribution requirements, we will qualify for effective pass-through tax treatment. We would cease to qualify for such pass-through tax treatment if we were unable to comply with these requirements. In addition, we may have difficulty meeting the requirement to make distributions to our shareholders because in certain cases we may recognize income before or without receiving cash representing such income. If we fail to qualify as a regulated investment company, we will have to pay corporate-level taxes on all of our income whether or not we distribute it, which would substantially reduce the amount of income available for distribution to our stockholders. Even if we qualify as a regulated investment company, we generally will be subject to a corporate-level income tax on the income we do not distribute. Moreover, if we do not distribute at least 98% of our income, we generally will be subject to a 4% excise tax.

**There is a risk that you may not receive dividends or distributions.** We intend to make distributions on a quarterly basis to our stockholders. We may not be able to achieve operating results that will allow us to make distributions at a specific level or to increase the amount of these distributions from time to time. In addition, due to the asset coverage test applicable to us as a business development company, we may be limited in our ability to make distributions. Also, our credit facilities limit our ability to declare dividends if we default under certain provisions. If we do not distribute a certain percentage of our income annually, we will suffer adverse tax consequences, including possible loss of our status as a regulated investment company. In addition, in accordance with accounting principles generally accepted in the United States of America and tax regulations, we include in income certain amounts that we have not yet received in cash, such as contractual payment-in-kind interest which represents contractual interest added to the loan balance that becomes due at the end of the loan term. The increases in loan balances as a result of contractual payment-in-kind arrangements are included in income in advance of receiving cash payment, and are separately included in the change in accrued or reinvested interest and dividends in our consolidated statement of cash flows. Since we may recognize income before or without receiving cash representing such income, we may have difficulty meeting the requirement to distribute at least 90% of our income to maintain our status as a regulated investment company.

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

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

**Changes in the law or regulations that govern us could have a material impact on us or our operations.** We are regulated by the SEC and the Small Business Administration. In addition, changes in the laws or regulations that govern business development companies, regulated investment companies, real estate investment trusts, and small business investment companies may significantly affect our business. Any change in the law or regulations that govern our business could have a material impact on us or our operations. Laws and regulations may be changed from time to time, and the interpretations of the relevant laws and regulations also are subject to change.

**Results may fluctuate and may not be indicative of future performance.** Our operating results will fluctuate and, therefore, you should not rely on current or historical period results to be indicative of our performance in future reporting periods. Factors that could cause operating results to fluctuate include, among others, variations in the investment origination volume and fee income earned, variation in timing of prepayments, variations in and the timing of the recognition of realized and unrealized gains or losses, the degree to which we encounter competition in our markets and general economic conditions.

**Our common stock price may be volatile.** The trading price of our common stock may fluctuate substantially. The price of the common stock may be higher or lower than the price you pay for your shares, depending on many factors, some of which are beyond our control and may not be directly related to our operating performance. These factors include the following:

- price and volume fluctuations in the overall stock market from time to time;
- significant volatility in the market price and trading volume of securities of business development companies or other financial services companies;
- volatility resulting from trading in derivative securities related to our common stock including puts, calls, long-term equity anticipation securities, or LEAPs, or short trading positions;
- changes in regulatory policies or tax guidelines with respect to business development companies or regulated investment companies;
- actual or anticipated changes in our earnings or fluctuations in our operating results or changes in the expectations of securities analysts;
- general economic conditions and trends;
- loss of a major funding source; or
- departures of key personnel.

Recently, the trading price of our common stock has been volatile. Due to the continued potential volatility of our stock price, we may be the target of securities litigation in the future. Securities litigation could result in substantial costs and divert management s attention and resources from our business. For information about current securities class action lawsuits filed against us, see Business Legal Proceedings.

**If you choose not to exercise your subscription rights your interest in us will be diluted.** Shareholders who do not fully exercise their basic subscription rights will, upon completion of the rights offering, own a smaller interest in us than they owned prior to the rights offering. This rights offering will dilute the ownership interest and voting power of shareholders who do not fully exercise their basic subscription rights.

## Disclosure Regarding Forward-Looking Statements

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

Although we believe that the assumptions on which these forward-looking statements are based are reasonable, any of those assumptions could prove to be inaccurate, and as a result, the forward-looking statements based on those assumptions also could be incorrect. Important assumptions include our ability to originate new investments, maintain certain margins and levels of profitability, access the capital markets for debt and equity capital, the ability to meet regulatory requirements and the ability to maintain certain debt to asset ratios. In light of these and other uncertainties, the inclusion of a projection or forward-looking statement in this prospectus should not be regarded as a representation by us that our plans and objectives will be achieved. These risks and uncertainties include those described in Risk Factors and elsewhere in this prospectus and any exhibits of the registration statement of which this prospectus is a part. You should not place undue reliance on these forward-looking statements, which apply only as of the date of this prospectus.

## THE RIGHTS OFFERING

### Terms of the Offer

We are issuing to our shareholders of record on the record date, October 21, 2002, non-transferable rights to subscribe for the shares of our common stock. Each shareholder is being issued one non-transferable right for each share of common stock owned on the record date. For every 20 rights held you will be able to purchase one share of our common stock at the subscription price. Rights may be exercised at any time during the subscription period, which commences on October 21, 2002 and ends at 5:00 p.m., New York City time, on November 21, 2002.

In addition, any shareholder who fully exercises all rights initially issued is entitled to subscribe for shares which were not purchased for by other shareholders pursuant to their basic subscription rights and will have an opportunity to indicate on the subscription certificate how many shares they are willing to acquire pursuant to their over-subscription right. Shares acquired pursuant to the over-subscription right are subject to proration, which is more fully discussed below under Subscription Rights Over-Subscription Right.

Rights will be evidenced by subscription certificates. The number of rights issued to each holder will be stated on the subscription certificate delivered to such holder. The method by which rights may be exercised and shares paid for is explained in the sections entitled Method of Exercise of Rights and Payment for Shares. A rights holder will have no right to rescind a purchase after the subscription agent has received the holder s subscription certificate or notice of guaranteed delivery. Shares of common stock issued pursuant to an exercise of rights will be listed on the NYSE.

The rights are non-transferable. Only the underlying shares of common stock, and not the rights, will be admitted for trading on the NYSE. Fractional shares will not be issued upon exercise of rights. Since fractional shares will not be issued, rights holders who receive, or who are left with, fewer than 20 rights will be unable to exercise such rights and will not be entitled to receive any cash in lieu of such fractional shares.

Participants in our dividend reinvestment plan will be issued rights for the common stock held in their accounts in the dividend reinvestment plan as of the record date. Participants wishing to exercise such rights must exercise such rights in accordance with the procedures set forth below in Method of Exercise of Rights and Payment for Shares. Such rights will not be exercised automatically by the dividend reinvestment plan. The rights must be exercised separately for each account and fractional shares may not be aggregated between accounts.

### Purpose Of The Offer

Our board of directors has determined that this rights offering is in our best interest and in the best interests of our shareholders. The offering gives existing shareholders the right to purchase additional shares at a price that may be below market without incurring any commission or charge. The offering will increase the equity capital available for making additional investments in the debt or equity of primarily private companies or non-investment grade commercial mortgage-backed securities and other general corporate purposes. In connection with the approval of this rights offering, our board of directors considered, among other things, the following factors:

- the size of the discount to the market price;

the increased equity capital to be available upon completion of the rights offering for making additional investments consistent with Allied Capital s investment objectives;

the dilution to non-exercising shareholders;

the terms and expenses of the offering;

the size of the offering in relation to the number of shares outstanding;

the market price of Allied Capital s common stock, both before and after the announcement of the equity offering;

the general condition of the securities markets; and

the use to be made of the proceeds from the offering and the return to shareholders upon such use.

There can be no assurance of the amount of dilution that a shareholder will experience or that the rights offering will be successful.

The purpose of setting the determination of the subscription price subsequent to the expiration date is to attract the maximum participation of shareholders in the offer, with minimum dilution to non-participating shareholders.

We believe the rights offering will be a low-cost method for raising additional capital since no underwriting or sales commission will be paid in respect of the shares purchased in the rights offering. We may, in the future and at our discretion, choose to make additional rights offerings of shares from time to time for a number of shares and on terms that may or may not be similar to this rights offering. Any such future offering will be made in accordance with applicable law.

**The Subscription Price**

The subscription price per share is 93% of the average of the last reported sales price of a share of our common stock on the NYSE on November 21, 2002, which we refer to as the pricing date, and each of the four preceding business days. The subscription price is expected to be above our net asset value. See Price Range of Common Stock and Distributions. Since the expiration date of the rights offering coincides with the pricing date, shareholders exercising their subscription rights will not know the subscription price per share at the time they exercise their subscription rights. It may be more or less than the estimated subscription price of $20.34 per share. If the actual subscription price is lower, excess payments will be refunded (without interest), and if the actual subscription price is higher, shareholders exercising rights must make an additional payment by December 20, 2002.

**Determination of the Subscription Price**

The subscription price has been determined by our board of directors, and will represent a discount to the market price of our common stock based upon the average of the last reported sales price of a share of our common stock on the New York Stock Exchange on November 21, 2002, and the four preceding business days. The factors considered, among others, by our board of directors in determining the subscription price included those factors described under Purpose Of The Offer and the following factors:

the absence of underwriting fees or sales commission (which range from 5% to 7% of offering proceeds) in connection with rights offering;

the pricing terms in other recently completed rights offerings; and desirability of ensuring significant shareholder participation in the rights offering.

**Distribution Of Rights**

We will issue to each holder of our common stock at no cost one non-transferable right to purchase our common stock for each share of our common stock owned by that holder as of the record date, which is October 21, 2002. No fractional rights will be issued. For every 20 rights held you will be entitled to purchase one share of common stock at the subscription price. The subscription price per share will be 93% of the average of the last reported sales price of a share of our common stock on the New York Stock Exchange on November 21, 2002, which we refer to as the pricing date, and the four preceding business days. Fractional shares will not be issued upon exercise of rights.

**Subscription Rights**

Your rights entitle you to the basic subscription rights and the over-subscription right.

***Basic Subscription Rights.*** The basic subscription rights entitle you to purchase one share of our common stock at the subscription price for every 20 rights issued to you. You are entitled to subscribe for all or any portion of the shares of our common stock underlying your basic subscription rights.

***Over-Subscription Right.*** If you elect to purchase all of the shares of our common stock that you are entitled to purchase under your basic subscription rights such that you have fewer than 20 rights remaining after such election, you will also have an over-subscription right to subscribe for additional shares of our common stock, if any, that are not purchased by other holders of rights under their basic subscription rights as of the expiration date. Although you are not limited in the number of shares you can elect to over-subscribe for, your ability to purchase the number of shares that you wish to purchase in the exercise of your over-subscription right will depend on the availability of such shares. We cannot provide any assurance that sufficient shares will be available to satisfy your request in whole or in part. If, however, the number of shares of our common stock remaining unsold after holders have exercised their basic subscription rights is sufficient to satisfy in full all subscriptions submitted for additional shares, we will allocate the shares according to the subscriptions submitted. Shares of our common stock purchased through your over-subscription right must be purchased at the subscription price.

***Proration of Over-Subscription Right.*** If the number of shares of our common stock remaining unsold after holders have exercised their basic subscription rights is not sufficient to satisfy in full all subscriptions submitted for additional shares, we will allocate the available shares pro rata among all holders who exercise their over-subscription right based on the number of shares each subscriber for additional shares has elected to purchase under their basic subscription rights. Each holder who subscribes for additional shares will be allocated available shares of our common stock in proportion to the amount each holder elected to purchase under their basic subscription rights. We will continue this allocation process until all subscriptions are filled or all the shares of our common stock offered in this offering have been sold. The allocation process may involve a series of allocations in order to assure the total number of shares available for over-subscription is distributed on a pro rata basis. In the case of rights exercised by a nominee for a beneficial owner, the allocation described above will be based upon the number of shares of our common stock that the beneficial owner has elected to purchase under their basic subscription rights.

***Full Exercise of Basic Subscription Rights.*** You may exercise your over-subscription right only if you exercise your basic subscription rights in full by electing to purchase all of the shares of common stock which you are entitled to purchase under your basic subscription rights such that you have fewer than 20 rights remaining after such exercise. To determine if you have fully exercised your basic subscription rights, we will consider only the basic subscription rights held by you in the same capacity. For example, suppose that you were granted rights for shares of our common stock which you own individually and shares of our common stock which you own collectively with your spouse. If you wish to exercise your over-subscription right with respect to the rights you own individually, but not with respect to the rights you own collectively with your spouse, you only need to fully exercise your basic subscription rights with respect to your individually owned rights. You do not have to subscribe for any shares under the basic subscription rights owned collectively with your spouse to exercise your individual over-subscription right.

When you complete the portion of your subscription certificate to exercise your over-subscription right, you will be representing that you have fully exercised your basic subscription rights as to shares of our common stock which you hold in that capacity. You must exercise your over-subscription right at the same time you exercise your basic subscription rights in full.

If you own shares of our common stock through your bank, broker or other nominee holder who will exercise your subscription right on your behalf, the bank, broker or other nominee holder will be required to certify to us and to the subscription agent the following information:

- the number of shares of our common stock held on your behalf on the record date;
- the number of rights exercised under your basic subscription rights;
- that your basic subscription rights held in the same capacity have been exercised in full; and
- the number of shares subscribed for under your over-subscription right.

Your bank, broker or other nominee holder may also disclose to us other information received from you.

**No Fractional Rights and Shares**

We will not issue fractional rights or fractional shares. Since fractional shares will not be issued, rights holders who receive, or who are left with, fewer than 20 rights will be unable to exercise such rights and will not be entitled to receive any cash in lieu of such fractional shares.

**Method of Exercise of Rights**

Subscription certificate(s), which evidence the subscription rights, will be mailed to shareholders of record as of the record date. Rights may be exercised by shareholders who are record owners by filling in and signing the enclosed subscription certificate(s) and mailing it in the envelope provided or delivering the completed and signed subscription certificate(s) to the subscription agent, together with required payment for the shares as described below under Payment for Shares. Rights may also be exercised by a shareholder by contacting his broker, bank or other nominee, who can arrange, on the shareholder s behalf, delivery of a properly completed and executed subscription certificate(s) and payment for the shares. A fee may be charged for this service. Unless shareholders are delivering their subscription certificates pursuant to a notice of guaranteed delivery as described below under Notice of Guaranteed Delivery, subscription certificate(s) must be received by the subscription agent prior to 5:00 p.m., New York City time, on the expiration date at the offices of the subscription agent.

**Payment for Shares**

Shareholders who acquire shares pursuant to the basic subscription rights or the over-subscription right must send payment for the shares to be acquired pursuant to the basic subscription rights and over-subscription right, to the subscription agent based on the estimated subscription price of $20.34 per share. To be accepted, such payment must be made payable to American Stock Transfer & Trust Company, as subscription agent Allied Capital Corporation and received by the subscription agent prior to 5:00 p.m. New York City time on the expiration date, unless the rights offering is extended. The subscription agent will not honor any exercise of rights received by it after the expiration date. The subscription agent will deposit all bank checks, checks, money orders and wire transfers of funds received by it prior to the final payment date into a segregated interest-bearing account (which interest will be paid to us) pending proration and issuance of shares. If this offering is terminated, we will promptly arrange for the refund, without interest, of all funds received from holders of rights. **All payments by a shareholder must be made in United States dollars either (i) by bank check, money order or check and drawn on a bank located in the United States, or (ii) by wire transfer of same day funds to the account maintained by the subscription agent for this purpose at American Stock Transfer & Trust Company, Subscription Agent for Allied Capital Corporation, JP Morgan Chase, 55 Water Street, ABA# 021-000021, Account No. 323-113060.**

Unless you are delivering your subscription certificate pursuant to a notice of guaranteed delivery as described below under Notice of Guaranteed Delivery, payment of the estimated subscription price must be accompanied by a subscription certificate.

**Notice of Guaranteed Delivery**

If you wish to exercise your rights, but time will not permit you to cause the subscription certificate to reach the subscription agent on or prior to the expiration date, you may nevertheless exercise your rights if you meet the following conditions:

(a) you have caused payment in full of the estimated subscription price for each share being subscribed for pursuant to your basic subscription rights and your over-subscription right, if any, to be received by the subscription agent on or prior to the expiration date;

(b) the subscription agent receives, on or prior to the expiration date, a guaranteed notice, from an eligible institution, stating your name, the number of rights held, the number of shares being subscribed for pursuant to the basic subscription rights and the number of shares being subscribed for pursuant to the over-subscription right, and guaranteeing the delivery to the subscription agent of the subscription certificate at or prior to 5:00 p.m., New York City time, on the date three (3) business days following the expiration date; and

(c) the properly completed subscription certificate evidencing the rights being exercised, with any required signatures being guaranteed, are received by the subscription agent at or prior to 5:00 p.m., New York City time, on the date three (3) business days following the expiration date.

**Delivery of Shares**

Unless requested otherwise, stock certificates will not be issued for shares of our common stock offered in this rights offering. Shareholders who are record owners will have the shares they acquire credited to their account with our transfer agent. All future dividends paid on such shares will be paid either in cash or reinvested into additional shares, depending on the election you made in connection with our dividend reinvestment plan. Shareholders whose common stock are held by a nominee will have the shares they acquire credited to the account of such nominee holder.

**Signature Guarantee May Be Required**

Your signature on each subscription certificate must be guaranteed by an eligible institution such as a member firm of a registered national securities exchange or a member of the NASD, or from a commercial bank or trust company having an office or correspondent in the United States, subject to standards and procedures adopted by the subscription agent, unless:

Your subscription certificate provides that shares are to be delivered to you as record holder of those rights; or

You are an eligible institution.

**Confirmation of Purchase**

Within 10 business days following the expiration of the rights offering, which we refer to as the confirmation date, a confirmation will be sent by the subscription agent to each shareholder (or, if shares are held by a nominee, on the record date, to such nominee) showing: (i) the number of shares acquired through the basic subscription rights; (ii) the number of shares, if any, acquired through the over-subscription right; (iii) the per share and total subscription price for the shares; and (iv) the additional amount payable by the shareholder to us or any excess to be refunded (without interest) by us to the shareholder, in each case based on the subscription price as determined on the pricing date.

In the case of any stockholder who exercises a right to acquire shares through the over-subscription right, any excess payment which would otherwise be refunded to the shareholder will be applied by us toward payment for shares acquired through exercise of the over-subscription right. Any additional payment required from a shareholder must be received by the subscription agent within 10 business days after the confirmation date, and any excess payment to be refunded (without interest) by us to a shareholder will be mailed by the subscription agent to such shareholder as soon as practicable. All payments by a shareholder must be in U.S. dollars by (i) bank check, money order or check drawn on a bank located in the U.S. and payable to American Stock Transfer & Trust Company, as subscription agent Allied Capital Corporation, or (ii) by wire transfer of same day funds to the account maintained by the subscription agent for this purpose at American Stock Transfer & Trust Company, Subscription Agent for Allied Capital Corporation, JP Morgan Chase, 55 Water Street, ABA# 021-000021, Account No. 323-113060.

Crediting of shares acquired in this rights offering to any account is subject to collection of checks.

If a shareholder who acquires shares through the basic subscription rights or over-subscription right does not make payment of all amounts due, we reserve the right to (i) apply any payment actually received by us toward the purchase of the greatest number of whole shares which could be acquired by such shareholder upon exercise of the basic subscription rights or over-subscription right; (ii) exercise any and all other rights or remedies to which we may be entitled; or (iii) find other purchasers for such subscribed-for shares.

**Shareholders will have no right to rescind their subscription after receipt of their payment for shares by the subscription agent.**

**Instructions For Completing Your Subscription Certificate**

You should read and follow the instructions accompanying the subscription certificates carefully. If you want to exercise your rights, you should send your subscription certificate(s) with your estimated subscription price payment to the subscription agent. **Do not send your subscription certificate(s) and estimated subscription price payment to us.**

**Information Agent**

Any questions or requests for assistance may be directed to the information agent at its telephone number and address listed below:

The information agent for the rights offering is:

Georgeson Shareholder Communications, Inc.

17 State Street
New York, NY 10004

Banks and Brokers Call

(212) 440-9800

All Others Call Toll-Free

(866) 206-4938

Shareholders may also contact their brokers, banks or other nominees for information with respect to the rights offering.

The information agent will receive a fee estimated to be approximately $25,000, which excludes reimbursement for all out-of-pocket expenses related to the rights offering, and have also agreed to indemnify the information agent against certain liabilities which it may incur in connection with this offering.

**Subscription Agent**

American Stock Transfer & Trust Company will act as our subscription agent to accept exercises of subscription rights for this offering. You must send the completed and signed certificate, along with payment in full of the exercise price for all shares that you wish to purchase pursuant to the basic subscription rights and over-subscription right, to American Stock Transfer & Trust Company.

We suggest, for your protection, that you deliver your subscription certificate to the subscription agent by an insured, overnight or express mail courier. If you mail your subscription certificate, we suggest that you use registered mail. If you wish to exercise your rights, you should mail or deliver your subscription certificate and payment for the estimated subscription price to the subscription agent as follows:

<u>By Mail, Hand or Overnight Courier</u>

American Stock Transfer & Trust Company

59 Maiden Lane, Plaza Level
New York, New York 10038

The notice of guaranteed delivery may also be sent by facsimile to (718) 234-5001 with the originals to be sent promptly thereafter by the methods described above. Facsimiles should be confirmed by telephone to (718) 921-8200.

**Delivery to an address other than as listed above, or transmission via a facsimile number other than as listed above, will not constitute valid delivery.**

Any questions or requests for assistance concerning the method of subscribing for shares of our common stock or for additional copies of this prospectus or the instructions as to use of the subscription certificates can be directed to the information or subscription agent at the addresses or at the telephone numbers specified above.

We will pay the subscription agent fees and expenses of up to $35,000 and have also agreed to indemnify the subscription agent against certain liabilities which it may incur in connection with this offering.

**Expiration Of The Rights Offering**

You may exercise your subscription rights at any time before 5:00 p.m., New York City time, on November 21, 2002, the expiration date for this offering. We may, in our sole discretion, extend the time for exercising your rights. If you do not exercise your rights before the expiration date, your unexercised rights will be null and void. We may extend the expiration date by giving oral or written notice to the subscription agent on or before the scheduled expiration date and making a public announcement thereof no later than 9:00 a.m., New York City time, on the next business day after the previously scheduled expiration date. We will not be obligated to honor your exercise of rights if the subscription agent receives the documents relating to your exercise after the rights offering expires, regardless of when you transmitted the documents.

**Calculation Of Rights Exercised**

If you do not indicate the number of rights being exercised, or do not forward full payment of the total estimated subscription price payment for the number of rights that you indicate are being exercised, then you will be deemed to have exercised your basic subscription rights with respect to the maximum number of rights that may be exercised with the aggregate estimated subscription price payment you delivered to the subscription agent. If your aggregate estimated subscription price payment is greater than the amount you owe for your basic subscription and you do not indicate the number of rights being exercised, you will be deemed to have exercised your over-subscription right to purchase the maximum number of shares with your overpayment. If we do not apply your full subscription price payment to your purchase of shares of our common stock, we will return the excess amount to you by mail without interest or deduction as soon as practicable after the expiration of rights offering.

**Nominee Holders**

If you are a broker, bank or other nominee who holds shares of our common stock for the account of others on October 21, 2002, the record date for this offering, you should notify the respective beneficial owners of such shares of the rights offering as soon as possible to find out their intentions with respect to exercising their rights. You should obtain instructions from the beneficial owner with respect to the rights, as set forth in the instructions we have provided to you for your distribution to beneficial owners. If the beneficial owner so instructs, you should complete the appropriate documents and submit them to the subscription agent with the proper payment. If you hold shares of our common stock for the account(s) of more than one beneficial owner, you may exercise the number of rights to which all such beneficial owners in the aggregate otherwise would have been entitled had they been direct record holders of our common stock on the record date for

this rights offering, provided that you, as a nominee record holder, make a proper showing to the subscription agent.

**Beneficial Owners**

If you are a beneficial owner of shares of our common stock or will receive your rights through a broker, bank or other nominee, we will ask your broker, bank or other nominee to notify you of this rights offering. To indicate your decision, you should complete and return to your bank, broker or other nominee the form entitled Beneficial Owner Election Form, together with full payment of the estimated subscription price for each share subscribed for under your subscription rights (including shares subscribed for through the exercise of your over-subscription right). You should receive this form from your broker, bank or other nominee with the other offering materials.

**Amendments And Waivers; Termination**

We reserve the right to amend the terms and conditions of this offering, whether the amended terms are more or less favorable to you. We will comply with all applicable laws, including the federal securities laws, in connection with any such amendment.

We will decide all questions as to the validity, form and eligibility (including times of receipt, beneficial ownership and compliance with other procedural matters) in our sole discretion, and our determination shall be final and binding. The acceptance of subscription certificates and the subscription price also will be determined by us. Alternative, conditional or contingent subscriptions will not be accepted. We reserve the right to reject any exercise if such exercise is not in accordance with the terms of this rights offering or not in proper form or if the acceptance thereof or the issuance of shares of our common stock thereto could be deemed unlawful. We reserve the right to waive any deficiency or irregularity with respect to any subscription certificate. Subscriptions will not be deemed to have been received or accepted until all irregularities have been waived or cured within such time as we determine in our sole discretion. We will not be under any duty to give notification of any defect or irregularity in connection with the submission of subscription certificates or incur any liability for failure to give such notification.

We reserve the right, in our sole discretion, at any time prior to delivery of the shares of our common stock offered hereby, to terminate the rights offering by giving oral or written notice thereof to the subscription agent and making a public announcement thereof. If this offering is terminated, we will promptly arrange for the refund, without interest, of all funds received from holders of rights. All monies received by the subscription agent in connection with this offering will be held by the subscription agent, on our behalf, in a segregated interest-bearing account. All such interest shall be payable to us even if we determine to terminate the offering and return your subscription payment.

**No Revocation**

Once you have exercised your subscription rights, you may not revoke the exercise.

**No Transfer Of Rights**

All rights received by you in this offering are non-transferable and may only be exercised by a subscribing holder for his or her own account. The rights will not be admitted for trading on the NYSE. However, the shares of our common stock issued through this rights offering will be listed and admitted for trading on the NYSE.

**Dilutive Effects**

Any shareholder who chooses not to participate in this rights offering, should expect to own a smaller interest in us upon completion of this rights offering. This rights offering

will dilute the ownership interest and voting power of shareholders who do not fully exercise their basic subscription rights.

**Foreign Restrictions**

Shareholders whose record addresses are outside the United States (for these purposes, the United States includes its territories and possessions and the District of Columbia) will receive written notice of the rights offering; however, subscription certificates will not be mailed to such shareholders. The rights to which those subscription certificates relate will be held by the subscription agent for such foreign shareholder s accounts until instructions are received to exercise the rights. If no such instructions are received by the expiration date, such rights will expire.

**Employee Plan Considerations**

Shareholders that are employee benefit plans subject to the Employee Retirement Income Security Act of 1974, which we refer to as ERISA (including corporate savings and 401(k) plans), profit sharing/retirement plans for self-employed individuals and Individual Retirement Accounts, which we refer to as Retirement Plans, should be aware that additional contributions of cash to the Retirement Plan (other than rollover contributions or trustee-to-trustee transfers from other Retirement Plans) in order to exercise rights would be treated as Retirement Plan contributions and therefore, when taken together with contributions previously made, may be treated as excess or nondeductible contributions subject to excise taxes. In the case of Retirement Plans qualified under Section 401(a) of the Internal Revenue Code of 1986, additional cash contributions could cause violations of the maximum contribution limitations of Section 415 of