ALLIED CAPITAL CORP
Form 10-Q
August 10, 2009

FORM 10-Q

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

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

For The Quarterly Period
Ended June 30, 2009

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

Commission File Number:
0-22832

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

Maryland	**52-1081052**
(State or Jurisdiction of Incorporation or Organization)	*(IRS Employer Identification No.)*

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

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

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

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

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

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

(Do not check if a smaller reporting company)

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

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

ALLIED CAPITAL CORPORATION

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PART I: FINANCIAL INFORMATION

Item 1. ***Financial Statements***

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

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

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

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF OPERATIONS

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

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

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN NET ASSETS

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

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ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS

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

Cash at end of period	$ 68,985	$ 128,781

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ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF INVESTMENTS

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

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

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

(5) Non-registered investment company.

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

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

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ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

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

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

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

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

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

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

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(11) Represents the effective interest yield earned on the cost basis of these preferred equity investments and income notes. The yield is included in interest income in the consolidated statement of operations.

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

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

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

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ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

Private Finance Portfolio Company (in thousands, except number of shares)	**Investment[1][2]**	**Principal**	**June 30, 2009 (unaudited) Cost**	**Value**
Driven Brands, Inc.	Subordinated Debt (16.5%, Due 7/15)	$ 87,800	$ 87,424	$ 84,032
(Consumer Services)	Common Stock (3,772,098 shares)		9,516	2,200
	Total Investment		**96,940**	**86,232**
Multi-Ad Services, Inc.	Unitranche Debt (11.3%, Due 11/11)	2,516	2,497	2,453
(Business Services)	Equity Interests		1,737	1,247
	Total Investment		**4,234**	**3,700**
Pendum Acquisition, Inc.	Common Stock (8,872 shares)			
(Business Services)	**Total Investment**			
Postle Aluminum Company, LLC	Senior Loan (6.0%, Due 10/12)[6]	35,000	34,876	14,369
(Industrial Products)	Subordinated Debt (3.0%, Due 10/12)[6]	23,953	23,868	
	Equity Interests		2,174	
	Total Investment		**60,918**	**14,369**
Progressive International Corporation	Preferred Stock (500 shares)		500	1,171
	Common Stock (197 shares)		13	3,900
(Consumer Products)	Warrants			
	Total Investment		**513**	**5,071**
Regency Healthcare Group, LLC	Equity Interests		1,302	1,817
(Healthcare Services)	**Total Investment**		**1,302**	**1,817**

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

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ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

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

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

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(5) Non-registered investment company.

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

(11) Represents the effective interest yield earned on the cost basis of these preferred equity investments and income notes. The yield is included in interest income in the consolidated statement of operations.

(12) Common stock is non-voting. In addition to non-voting stock ownership, the Company has an option to acquire a majority of the voting securities of the portfolio company at fair market value.

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

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

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

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ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

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

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

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ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

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

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

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ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

Private Finance Portfolio Company (in thousands, except number of shares)	**Investment[1][2]**	**June 30, 2009 (unaudited) Principal**	**Cost**	**Value**
Network Hardware Resale, Inc.	Unitranche Debt (12.8%, Due 12/11)	$ 16,618	$ 16,676	$ 16,618
(Business Services)	Convertible Subordinated Debt (9.8%, Due 12/15)	15,953	16,002	16,002
	Total Investment		**32,678**	**32,620**
Novak Biddle Venture Partners III, L.P.[5]	Limited Partnership Interest		2,018	1,221
(Private Equity Fund)	**Total Investment**		**2,018**	**1,221**
Oahu Waste Services, Inc.	Stock Appreciation Rights		206	385
(Business Services)	**Total Investment**		**206**	**385**
Pangaea CLO 2007-1 Ltd.[4]	Class D Notes (5.9%, Due 1/21)	15,000	11,919	6,190
(CLO)	**Total Investment**		**11,919**	**6,190**
PC Helps Support, LLC	Senior Loan (3.6%, Due 12/13)	8,417	8,328	7,795
(Business Services)	Subordinated Debt (12.8%, Due 12/13)	27,507	27,393	25,948
	Total Investment		**35,721**	**33,743**
Performant Financial Corporation	Common Stock (478,816 shares)		734	560
(Business Services)	**Total Investment**		**734**	**560**
Promo Works, LLC	Unitranche Debt (12.3%, Due 12/11)	23,111	22,980	17,566
(Business Services)	**Total Investment**		**22,980**	**17,566**

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

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ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

Private Finance Portfolio Company (in thousands, except number of shares)	**Investment(1)(2)**	**Principal**	**June 30, 2009 (unaudited) Cost**	**Value**
Tappan Wire & Cable Inc.	Unitranche Debt (15.0%, Due 8/14)(6)	$ 22,346	$ 22,248	$ 6,961
(Business Services)	Common Stock (12,940 shares)(12)		2,043	
	Warrant(12)			
	Total Investment		**24,291**	**6,961**
The Step2 Company, LLC	Unitranche Debt (11.0%, Due 4/12)	94,843	94,616	89,432
(Consumer Products)	Equity Interests		2,156	1,376
	Total Investment		**96,772**	**90,808**
Tradesmen International, Inc.	Subordinated Debt (12.0%, Due 12/12)	40,000	39,723	34,413
(Business Services)	**Total Investment**		**39,723**	**34,413**
TransAmerican Auto Parts, LLC	Subordinated Debt (18.3%, Due 11/12)(6)	24,561	24,409	
(Consumer Products)	Equity Interests		1,034	
	Total Investment		**25,443**	
Trover Solutions, Inc.	Subordinated Debt (12.0%, Due 11/12)	56,676	56,496	53,019
(Business Services)	**Total Investment**		**56,496**	**53,019**
United Road Towing, Inc.	Subordinated Debt (11.8%, Due 1/14)	19,060	18,984	18,641
(Consumer Services)	**Total Investment**		**18,984**	**18,641**

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

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(5) Non-registered investment company.
(6) Loan or debt security is on non-accrual status and therefore is considered non-income producing.
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ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

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

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

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

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

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

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

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ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF INVESTMENTS

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

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

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(5) Non-registered investment company.

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

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ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

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

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

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(6) Loan or debt security is on non-accrual status and therefore is considered non-income producing.
(8) Crescent Equity Corp. holds investments in Crescent Hotels & Resorts, LLC and affiliates.

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ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

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

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

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ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

Private Finance Portfolio Company (in thousands, except number of shares)	**Investment[1][2]**	**December 31, 2008 Principal**	**Cost**	**Value**
Knightsbridge CLO 2008-1 Ltd.[4]	Class C Notes (9.3%, Due 6/18)	$ 12,800	$ 12,800	$ 12,800
(CLO)	Class D Notes (10.3%, Due 6/18)	8,000	8,000	8,000
	Class E Notes (6.8%, Due 6/18)	13,200	10,573	10,573
	Income Notes (16.6%)[11]		21,315	21,315
	Total Investment		**52,688**	**52,688**
MHF Logistical Solutions, Inc.	Subordinated Debt (13.0%, Due 6/12 6/13)[6]	49,841	49,633	
(Business Services)	Preferred Stock (10,000 shares)			
	Common Stock (20,934 shares)		20,942	
	Total Investment		**70,575**	
MVL Group, Inc.	Senior Loan (12.0%, Due 6/09 7/09)	30,674	30,663	30,663
(Business Services)	Subordinated Debt (14.5%, Due 6/09 7/09)	41,074	40,994	40,994
	Subordinated Debt (3.0%, Due 6/09)[6]	144	139	86
	Common Stock (560,716 shares)		555	
	Total Investment		**72,351**	**71,743**
Old Orchard Brands, LLC	Subordinated Debt (18.0%, Due 7/14)	18,951	18,882	18,882
(Consumer Products)	Equity Interests		16,857	27,763
	Total Investment		**35,739**	**46,645**
Penn Detroit Diesel Allison, LLC		37,984	37,869	37,869

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

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ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

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

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

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ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

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

Companies Less Than 5% Owned

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

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ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

Private Finance Portfolio Company (in thousands, except number of shares)	**Investment[1][2]**	**December 31, 2008 Principal**	**Cost**	**Value**
Baird Capital Partners IV Limited[5]	Limited Partnership Interest		$ 3,636	$ 2,978
(Private Equity Fund)	**Total Investment**		**3,636**	**2,978**
BenefitMall Holdings Inc.	Subordinated Debt (18.0%, Due 6/14)	$ 40,326	40,238	40,238
(Business Services)	Common Stock (39,274,290 shares)[12]		39,274	91,149
	Warrants[12]			
	Total Investment		**79,512**	**131,387**
Broadcast Electronics, Inc.	Senior Loan (8.8%, Due 11/11)[6]	4,912	4,884	773
(Business Services)	Preferred Stock (2,044 shares)			
	Total Investment		**4,884**	**773**
Bushnell, Inc.	Subordinated Debt (8.0%, Due 2/14)	41,325	40,003	35,794
(Consumer Products)	**Total Investment**		**40,003**	**35,794**
Callidus Debt Partners	Class C Notes (12.9%, Due 12/13)	18,800	18,907	10,116
CDO Fund I, Ltd.[4][10]	Class D Notes (17.0%, Due 12/13)	9,400	9,454	
(CDO)				
	Total Investment		**28,361**	**10,116**
Callidus Debt Partners	Preferred Shares (23,600,000 shares)		20,138	5,402
CLO Fund III, Ltd.[4][10]				
(CLO)	**Total Investment**		**20,138**	**5,402**

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

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ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

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

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

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ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

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

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

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ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

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

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

(1) Interest rates represent the weighted average annual stated interest rate on loans and debt securities, which are presented by nature of indebtedness for a single issuer. The maturity dates represent the earliest and the latest maturity dates.

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

(3) Public company.

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

(5) Non-registered investment company.

(12) Common stock is non-voting. In addition to non-voting stock ownership, the Company has an option to acquire a majority of the voting securities of the portfolio company at fair market value.

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

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

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

(1) Interest rates represent the weighted average annual stated interest rate on loans and debt securities, which are presented by nature of indebtedness for a single issuer. The maturity dates represent the earliest and the latest maturity dates.

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

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

(5) Non-registered investment company.

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

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

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

(1) Interest rates represent the weighted average annual stated interest rate on loans and debt securities, which are presented by nature of indebtedness for a single issuer. The maturity dates represent the earliest and the latest maturity dates.

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

(5) Non-registered investment company.

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

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

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

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

(1) Interest rates represent the weighted average annual stated interest rate on loans and debt securities, which are presented by nature of indebtedness for a single issuer. The maturity dates represent the earliest and the latest maturity dates.

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

(5) Non-registered investment company.

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

(12) Common stock is non-voting. In addition to non-voting stock ownership, the Company has an option to acquire a majority of the voting securities of the portfolio company at fair market value.

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

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

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

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

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

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

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Information at and for the three and six months ended June 30, 2009 and 2008 is unaudited)

Note 1. Organization

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

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

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

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

Events of Default, Liquidity and Operations

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

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

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

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 1. Organization, continued

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

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

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

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

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

Note 2. Summary of Significant Accounting Policies

Basis of Presentation

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2. Summary of Significant Accounting Policies, continued

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

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

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

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

The Company adopted SFAS 157 on a prospective basis in the first quarter of 2008. SFAS 157 requires the Company to assume that the portfolio investment is to be sold in the principal market to market participants, or in the absence of a principal market, the most advantageous market, which may be a hypothetical market. Market participants are defined as buyers and sellers in the principal or most advantageous market that are independent, knowledgeable, and willing and able to transact. In accordance

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2. Summary of Significant Accounting Policies, continued

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

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

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

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2. Summary of Significant Accounting Policies, continued

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

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

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

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

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

Interest and Dividend Income

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2. Summary of Significant Accounting Policies, continued

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

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

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

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

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

Fee Income

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2. Summary of Significant Accounting Policies, continued

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

Guarantees

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

Financing Costs

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

Dividends to Shareholders

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

Stock Compensation Plans

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2. Summary of Significant Accounting Policies, continued

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

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

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

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

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

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

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2. Summary of Significant Accounting Policies, continued

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

Federal and State Income Taxes and Excise Tax

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

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

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

Per Share Information

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

Use of Estimates in the Preparation of Financial Statements

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

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2. Summary of Significant Accounting Policies, continued

2008, 79% and 94%, respectively, of the Company s total assets represented portfolio investments whose fair values have been determined by the Board of Directors in good faith in the absence of readily available market values. Because of the inherent uncertainty of valuation, the Board of Directors determined values may differ significantly from the values that would have been used had a ready market existed for the investments, and the differences could be material.

Recent Accounting Pronouncements

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

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

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

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

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

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

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

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

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

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

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

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

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3. Portfolio

Private Finance

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

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

(1) The weighted average yield on loans and debt securities is computed as the (a) annual stated interest on accruing loans and debt securities plus the annual amortization of loan origination fees, original issue discount, and market discount on accruing loans and debt securities less the annual amortization of loan origination costs, divided by (b) total loans and debt securities at value. At June 30, 2009, and December 31, 2008, senior loans included the senior secured loan to Ciena totaling $319.0 million and $319.0 million at cost, respectively, and $93.0 million and $104.9 million at value, respectively, which was placed on non-accrual status on the purchase date.

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

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

(2) Unitranche debt is an investment that combines both senior and subordinated financing, generally in a first lien position.

(3) Subordinated debt includes bonds in CLOs and in a CDO.

(4) The total principal balance outstanding on loans and debt securities was $2,802.2 million and $3,418.0 million at June 30, 2009, and December 31, 2008, respectively. The difference between principal and cost is represented by unamortized loan origination fees and costs, original issue discounts, and market discounts totaling $28.3 million and $33.5 million at June 30, 2009, and December 31, 2008, respectively.

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

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

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3. Portfolio, continued

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

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

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

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

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

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3. Portfolio, continued

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

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

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

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

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

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

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

2008.

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3. Portfolio, continued

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

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

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3. Portfolio, continued

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

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

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

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

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

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

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

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)