ALLIED CAPITAL CORP
Form 497
May 15, 2008

The information in this prospectus supplement is not complete and may be changed. A registration statement relating to these securities has been declared effective by the Securities and Exchange Commission. This prospectus supplement is not an offer to sell these securities and is not soliciting offers to buy these securities in any state where such offer or sale is not permitted.

Filed Pursuant to Rule 497
Registration Statement No. 333-150006

PROSPECTUS SUPPLEMENT
(To Prospectus dated May 14, 2008)

Subject to Completion, May 15, 2008

7,500,000 Shares

Common Stock

We are offering 7,500,000 shares of our common stock, par value $0.0001 per share. We will receive all of the net proceeds from the sale of our common stock.

Our common stock is traded on the New York Stock Exchange under the symbol ALD. The last reported sale price for our common stock on May 14, 2008, was $21.43 per share.

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

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

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

	Per Share	Total
Public offering price	$	$
Underwriting discount	$	$
Proceeds, before expenses, to us(1)	$	$

(1) Expenses payable by us are estimated to be approximately $510,000.

If all the shares are not sold at the public offering price, the underwriters may change the offering price and may offer shares from time to time for sale in negotiated transactions or otherwise, at market prices prevailing at the time of sale, at prices related to such prevailing market prices or otherwise.

The underwriters may also purchase from us up to an additional 1,125,000 shares of our common stock at the public offering price less the underwriting discount, to cover over-allotments, if any, within 30 days of the date of this prospectus supplement.

The underwriters are offering the shares of our common stock as described in Underwriting. Delivery of the shares will be made on or about May , 2008.

Morgan Stanley **Citi** **Deutsche Bank Securities** **Merrill Lynch & Co.**

BB&T Capital Markets
a division of Scott & Stringfellow, Inc.

Davenport & Company LLC

Morgan Keegan & Company, Inc.

The date of this prospectus supplement is May , 2008

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

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Prospectus Supplement

ABOUT THIS PROSPECTUS

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

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

FEES AND EXPENSES

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

Shareholder Transaction Expenses	
Sales load (as a percentage of offering price)[1]	%
Dividend reinvestment plan fees[2]	None
Annual Expenses (as a percentage of consolidated net assets attributable to common stock)[3]	
Expenses[4]	6.08%
Interest payments on borrowed funds[5]	5.68%
Acquired fund fees and expenses[6]	%
Total annual expenses[7][8]	11.76%

Example

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

	1 Year	3 Years	5 Years	10 Years
You would pay the following expenses on a $1,000 investment, assuming a 5.0% annual return	$	$	$	$

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

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

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

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

(3) Consolidated net assets attributable to common stock equals net assets (i.e., total consolidated assets less total consolidated liabilities), which at March 31, 2008, was $2.8 billion.

(4) Expenses represent our estimated operating expenses for the year ending December 31, 2008, including income tax expense (benefit) including excise tax, excluding interest on indebtedness. This percentage for the year ended December 31, 2007, was 6.80%. See Management s Discussion and Analysis of Financial Condition and Results of Operations in the accompanying prospectus.

(5) The Interest payments on borrowed funds represents our estimated interest expense for the year ending December 31, 2008 including interest related to usage under our revolving line of credit and new debt issuances during the remainder of 2008. We had outstanding borrowings of $2.2 billion at March 31, 2008. This percentage for the year ended December 31, 2007, was 4.77%. See Risk Factors in the accompanying prospectus.

(6) See our Consolidated Statement of Investments as of March 31, 2008, on pages F-76 through F-92 in the accompanying prospectus for our investments in funds.

(7) Total annual expenses as a percentage of consolidated net assets attributable to common stock are higher than the total annual expenses percentage would be for a company that is not leveraged. We borrow money to leverage our net assets and increase our total assets. The SEC requires that Total annual expenses percentage be calculated as a percentage of net assets, rather than the total assets, including assets that have been funded with borrowed monies. If the Total annual expenses percentage were calculated instead as a percentage of consolidated total assets, our Total annual expenses would be 6.55% of consolidated total assets.

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

USE OF PROCEEDS

We estimate that our net proceeds from the sale of the 7,500,000 shares of common stock we are offering will be approximately $ million and approximately $ million, if the underwriters over-allotment option is exercised in full, and after deducting the underwriting discount and estimated offering expenses payable by us. We may change the size of this offering based on demand and market conditions.

We expect to use the net proceeds from this offering to reduce borrowings under our revolving line of credit, if any, to invest in debt or equity securities in primarily privately negotiated transactions, and for other general corporate purposes. Amounts repaid under our revolving line of credit will remain available for future borrowings. At May 14, 2008, the interest rate on our revolving line of credit was approximately 4.6% and there was approximately $345.3 million outstanding. This revolving line of credit expires on April 11, 2011.

UNDERWRITING

Subject to the terms and conditions set forth in our underwriting agreement, we are offering the shares of our common stock described in this prospectus supplement through the underwriters named below. Morgan Stanley & Co. Incorporated, Citigroup Global Markets Inc., Deutsche Bank Securities Inc. and Merrill Lynch, Pierce, Fenner & Smith Incorporated are acting as representatives. Each of the underwriters has severally agreed to purchase the number of shares of common stock listed next to its name in the following table:

Name	Number of Shares
Morgan Stanley & Co. Incorporated	
Citigroup Global Markets Inc.	
Deutsche Bank Securities Inc.	
Merrill Lynch, Pierce, Fenner & Smith Incorporated	
BB&T Capital Markets, a division of Scott & Stringfellow, Inc.	
Davenport & Company LLC	
Morgan Keegan & Company, Inc.	
Total	7,500,000

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

The underwriters propose to offer the shares of common stock directly to the public at the public offering price set forth on the cover page of this prospectus supplement and to dealers at the public offering price less a concession not in excess of $ per share. If all the shares are not sold at the public offering price, the underwriters may change the offering price and may offer shares from time to time for sale in negotiated transactions or otherwise, at market prices prevailing at the time of sale, at prices related to such prevailing market prices or otherwise.

We have granted to the underwriters an option to purchase up to 1,125,000 additional shares of common stock from us at the public offering price set forth on the cover page of this prospectus supplement less the underwriting discount. The underwriters may purchase additional shares only to cover over-allotments made in connection with this offering and only within 30 days after the date of this prospectus supplement. The underwriters will offer any additional shares that they purchase on the terms described above. If the underwriters exercise this option, each will be obligated, subject to conditions contained in the underwriting agreement, to purchase a number of additional shares approximately proportionate to that underwriter s initial amount reflected in the above table.

The underwriting discounts and commissions per share are equal to the public offering price per share of common stock less the amount paid by the underwriters to us per share of common stock. The underwriting discounts and commissions are % of the public offering price. The following table shows the underwriting discount per share that we are to pay to the underwriters in connection with this offering. These amounts are shown assuming either no exercise or full exercise by the underwriters of the underwriters over-allotment option:

		Total Fees	
	Fee Per Share	**Without Exercise of Over-Allotment Option**	**With Full Exercise of Over-Allotment Option**
Underwriting Discount	$	$	$

We estimate that the total expenses of this offering, which will be paid by us, excluding the underwriting discount, will be approximately $510,000.

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

We and certain of our executive officers have agreed not to offer, sell, contract to sell or otherwise dispose of, or to engage in certain hedging and derivative transactions with respect to, our common stock for a period of 30 days after the date of this prospectus supplement, without first obtaining the written consent of Morgan Stanley & Co. Incorporated, Citigroup Global Markets Inc., Deutsche Bank Securities Inc. and Merrill Lynch, Pierce, Fenner & Smith Incorporated on behalf of the underwriters, except in limited circumstances, including our additional issuance of equity securities through privately negotiated transactions that may or may not involve an underwriter, whether or not registered with the SEC, aggregating not more than $150 million. This consent may be given at any time without public notice.

The underwriters do not intend to confirm sales to any account over which they exercise discretionary authority.

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

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

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

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

The underwriters may impose a penalty bid. This occurs when a particular underwriter repays to the other underwriters a portion of the underwriting discount received by it because the representatives of the underwriters have repurchased shares sold by or for the account of that underwriter in stabilizing or short covering transactions.

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

The underwriters may make prospectuses available in electronic (PDF) format. A prospectus in electronic (PDF) format may be made available on a web site maintained by the underwriters, and the underwriters may distribute such prospectuses electronically. The underwriters intend to allocate a limited number of shares for sale to their online brokerage customers.

In the ordinary course of business, the underwriters or their affiliates have engaged and may in the future engage in various financing, commercial banking and investment banking services with, and provide financial advisory services to, us and our affiliates or controlled portfolio companies, for which they have received or may receive customary fees and expenses. Affiliates of Morgan Stanley & Co. Incorporated, Citigroup Global Markets Inc., Deutsche Bank Securities Inc., Merrill Lynch, Pierce, Fenner & Smith Incorporated and BB&T Capital Markets, a division of Scott & Stringfellow, Inc. are members of the lending syndicate for our unsecured revolving line of credit and will receive proceeds of this offering by reason of the repayment of amounts outstanding thereunder. Because more than 10% of the net proceeds of the offering may be received by members of FINRA participating in the offering or their affiliates, the offering is being conducted in accordance with FINRA Conduct Rule 2710(h).

The principal business address of Morgan Stanley & Co. Incorporated is 1585 Broadway, New York, NY 10036. The principal business address of Citigroup Global Markets Inc. is 388 Greenwich Street, New York, NY 10013. The principal business address of Deutsche Bank Securities Inc. is 60 Wall Street, 4th Floor, New York, NY 10005. The principal business address of Merrill Lynch, Pierce, Fenner & Smith Incorporated is 4 World Financial Center, 250 Vesey Street, New York, NY 10080.

LEGAL MATTERS

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

PROSPECTUS

50,000,000 Shares

Common Stock

We may offer, from time to time, up to 50,000,000 shares of our common stock in one or more offerings.

The shares of common stock may be offered directly to one or more purchasers, through agents designated from time to time by us, or to or through underwriters or dealers. The price and terms of any offering, including any applicable fee, commission or discount arrangement between us and any agents or underwriters or among our underwriters, or the basis upon which such amount may be calculated will be described in one or more supplements to this prospectus. See Plan of Distribution.

We are an internally managed closed-end, non-diversified management investment company that has elected to be regulated as a business development company under the Investment Company Act of 1940.

Our investment objective is to achieve current income and capital gains. We seek to achieve our investment objective by investing in primarily private middle market companies in a variety of industries. No assurances can be given that we will continue to achieve our objective.

Please read this prospectus and the accompanying prospectus supplement, if any, before investing, and keep it for future reference. The prospectus and the accompanying prospectus supplement contain important information about us that a prospective investor should know before investing in our common stock. We file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission. This information is available free of charge by contacting us at 1919 Pennsylvania Avenue, N.W., Washington, DC, 20006 or by telephone at (202) 721-6100 or on our website at www.alliedcapital.com. The SEC also maintains a website at www.sec.gov that contains such information.

Our common stock is traded on the New York Stock Exchange under the symbol ALD. As of May 12, 2008, the last reported sale price on the New York Stock Exchange for the common stock was $21.26.

You should review the information, including the risk of leverage, set forth under Risk Factors on page 10 of this prospectus before investing in our common stock.

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

This prospectus may not be used to consummate sales of shares of common stock unless accompanied by a prospectus supplement.

May 14, 2008

We have not authorized any dealer, salesman or other person to give any information or to make any representation other than those contained in this prospectus or an accompanying prospectus supplement, if any, to this prospectus. You must not rely upon any information or representation not contained in this prospectus or any such supplements as if we had authorized it. This prospectus and any such supplements do not constitute an offer to sell or a solicitation of any offer to buy any security other than the registered securities to which they relate, nor do they constitute an offer to sell or a solicitation of an offer to buy any securities in any jurisdiction to any person to whom it is unlawful to make such an offer or solicitation in such jurisdiction. The information contained in this prospectus and any such supplements is accurate as of the dates on their covers.

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ABOUT THIS PROSPECTUS

This prospectus is part of a registration statement that we have filed with the Securities and Exchange Commission using the shelf registration process. Under the shelf registration process, which constitutes a delayed offering in reliance on Rule 415 under the Securities Act of 1933, as amended, we may offer, from time to time, up to

50,000,000 shares of our common stock on the terms to be determined at the time of the offering. Shares of our common stock may be offered at prices and on terms described in one or more supplements to this prospectus. This prospectus provides you with a general description of the shares of our common stock that we may offer. Each time we use this prospectus to offer shares of our common stock, we will provide a prospectus supplement that will contain specific information about the terms of that offering. A prospectus supplement may also add, update or change information contained in this prospectus. Please carefully read this prospectus and any such supplements together with the additional information described under Where You Can Find Additional Information in the Prospectus Summary and Risk Factors sections before you make an investment decision.

A prospectus supplement may also add to, update or change information contained in this prospectus.

PROSPECTUS SUMMARY

The following summary contains basic information about this offering. It may not contain all the information that is important to an investor. For a more complete understanding of this offering, we encourage you to read this entire prospectus and the documents that are referred to in this prospectus, together with any accompanying supplements.

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

BUSINESS *(Page 78)*

We are a business development company in the private equity business and we are internally managed. Specifically, we provide long-term debt and equity capital to primarily private middle market companies in a variety of industries. We have participated in the private equity business since we were founded in 1958. Since then through March 31, 2008, we have invested more than $13 billion in thousands of companies nationwide. Our investment objective is to achieve current income and capital gains.

We believe the private equity capital markets are important to the growth of small and middle market companies because such companies often have difficulty accessing the public debt and equity capital markets. We use the term middle market to include companies with annual revenues typically between $50 million and $500 million. We believe that we are well positioned to be a source of capital for such companies.

We primarily invest in the American entrepreneurial economy. At March 31, 2008, our private finance portfolio included investments in 124 companies that generate aggregate annual revenues of over $13 billion and employ more than 98,000 people.

We generally target companies in less cyclical industries with, among other things, management teams with meaningful equity ownership, high returns on invested capital, the ability to generate free cash flow, and well-capitalized balance sheets. As a private equity investor, we spend significant time and effort identifying, structuring, performing due diligence, monitoring, developing, valuing, and ultimately exiting our investments.

Our investment activity is primarily focused on making long-term investments in the debt and equity of primarily private middle market companies. Debt investments may include senior loans, unitranche debt (an investment that combines both senior and subordinated financing, generally in a first lien position), or subordinated debt (with or without equity features). Equity investments may include a minority equity stake in connection with a debt investment or a substantial equity stake in connection with a buyout transaction. In a buyout transaction, we generally invest in senior debt, subordinated debt and equity (preferred and/or voting or non-voting common) where our equity ownership represents a significant portion of the equity, but may or may not represent a controlling interest.

Our investments in the debt and equity of primarily private middle market companies are generally long-term in nature and are privately negotiated, and no readily available market exists for them. This makes our investments highly illiquid and, as result, we cannot readily trade them. When we make an investment, we enter into a long-term arrangement where our ultimate exit from that investment may be three to ten years in the future.

The capital we provide is generally used by portfolio companies to fund buyouts, acquisitions, growth, recapitalizations, note purchases, or other types of financings.

Our investments are typically structured to provide recurring cash flow in the form of interest income to us as the investor. In addition to earning interest income, we may earn income from management, consulting, diligence, structuring, or other fees. We may also enhance our total return with capital gains realized from investments in equity instruments or from equity features, such as nominal cost warrants.

We provide managerial assistance to our portfolio companies, including, but not limited to, management and consulting services related to corporate finance, marketing, human resources, personnel and board member recruiting, business operations, corporate governance, risk management and other general business matters.

We have also participated in commercial real estate finance over our history. Over the past few years, we have not actively participated in commercial real estate finance as we believed that the market for commercial real estate had become too aggressive and that investment opportunities were not priced appropriately. As a result, our commercial real estate finance portfolio totaled $115.8 million at value, or 2.3% of our total assets, at March 31, 2008. As the capital markets evolve and should commercial real estate investment opportunities improve, we may become more active investors in commercial real estate finance for our own portfolio or through a future managed fund.

In addition to managing our own assets, we manage certain funds that also invest in the debt and equity securities of primarily middle market companies in a variety of industries, which we refer to as Managed Funds. We may invest in the equity of these funds, along with other third parties, from which we may earn a current return and/or future incentive allocation. We may also manage the assets held by these funds, for which we may earn management or other fees for our services.

We are internally managed, led by an experienced management team with our senior officers and managing directors possessing, on average, 22 years of experience. At March 31, 2008, we had 186 employees, who are focused on transaction sourcing, origination and execution, portfolio monitoring, accounting, valuation and other operational and administrative activities. We are headquartered in Washington, DC, with offices in New York, NY, Chicago, IL, and Los Angeles, CA and have centralized investment approval and portfolio management processes.

We have elected to be taxed as a regulated investment company under Subchapter M of the Internal Revenue Code of 1986, otherwise referred to as the Code. Assuming that we qualify as a regulated investment company, we generally will not be subject to corporate level income taxation on income we timely distribute to our stockholders as dividends. See Tax Status. We pay regular quarterly dividends based upon an estimate of annual taxable income available for distribution to shareholders and the amount of taxable income carried over from the prior year for distribution in the current year. Since 1963, our portfolio has provided sufficient ordinary taxable income and realized net capital gains to sustain or grow our dividends over time.

We are a Maryland corporation and a closed-end, non-diversified management investment company that has elected to be regulated as a business development company under the Investment Company Act of 1940, which we refer to as the 1940 Act.

As a business development company, we are required to meet certain regulatory tests, the most significant relating to our investments and borrowings. A business development company is required to invest at least 70% of its assets in eligible portfolio companies. A business development company must also maintain a coverage ratio of assets to senior securities of at least 200%. See Certain Government Regulations and Risk Factors.

Our executive offices are located at 1919 Pennsylvania Avenue, N.W., Washington, DC, 20006-3434 and our telephone number is (202) 721-6100. In addition, we have regional offices in New York, Chicago, and Los Angeles.

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

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

DETERMINATION OF
NET ASSET VALUE *(Page 102)*

Our portfolio investments are generally recorded at fair value as determined in good faith by our Board of Directors in the absence of readily available public market values.

Pursuant to the requirements of the 1940 Act, we value substantially all of our portfolio investments at fair value as determined in good faith by the Board of Directors on a quarterly basis. Since there is typically no readily available market value for the investments in our portfolio, our Board of Directors determines in good faith the fair value of these portfolio investments in accordance with our valuation policy and the provisions of the 1940 Act and FASB Statement No. 157, *Fair Value Measurements* (SFAS 157). In the first quarter of 2008, we adopted SFAS 157. The adoption of SFAS 157 did not change our requirement to record our investments at fair value.

There is no single approach for determining fair value in good faith. As a result, determining fair value requires that judgment be applied to the specific facts and circumstances of each portfolio investment while employing a consistently applied valuation process for the types of investments we make. Unlike banks, we are not permitted to provide a general reserve for anticipated loan losses. Instead, we are required to specifically value each individual investment on a quarterly basis. Because of the inherent uncertainty of determining the fair value of investments that do not have a readily available market value, the fair value of our investments determined in good faith by the Board of Directors may differ significantly from the values that would have been used had a ready market existed for the investments, and the differences could be material. Additionally, changes in the market environment and other events that may occur over the life of our investments may cause the gains or losses ultimately realized on our investments to be different than the values determined at the measurement date.

We adjust the valuation of our portfolio quarterly to reflect the change in the value of each investment in our portfolio. Any changes in value are recorded in our statement of operations as net change in unrealized appreciation or depreciation.

PLAN OF DISTRIBUTION *(Page 153)*

We may offer, from time to time, up to 50,000,000 shares of our common stock, on terms to be determined at the time of the offering.

Shares of our common stock may be offered directly to one or more purchasers, through agents designated from time to time by us, or to or through underwriters or dealers. The price and terms of any offering, including any applicable fee, commission or discount arrangement between us and any agents or underwriters or among our underwriters, or the basis upon which such amount may be calculated will be described in one or more supplements to this prospectus.

We may not sell shares of common stock pursuant to this prospectus without delivering a prospectus supplement describing the method and terms of the offering of such shares.

USE OF PROCEEDS *(Page 18)*

We intend to use the net proceeds from selling shares of common stock for general corporate purposes, which includes investing in debt or equity securities in primarily privately negotiated transactions, repayment of indebtedness, acquisitions and other general corporate purposes.

Any supplement to this prospectus relating to any offering of common stock will more fully identify the use of the proceeds from such offering.

PRICE RANGE OF COMMON STOCK AND DISTRIBUTIONS *(Page 19)*

We intend to pay quarterly dividends to holders of our common stock. The amount of our quarterly dividends is determined by our Board of Directors on a quarterly basis.

Shares of business development companies may trade at a market price that is less than the value of the net assets attributable to those shares. Our common stock currently continues to trade in excess of net asset value. The possibility that our shares of common stock will trade at a discount from net asset value or at premiums that are unsustainable over the long term is separate and distinct from the risk that our net asset value will decrease. There can be no assurance, however, that our shares will continue to trade at a premium to our net asset value.

DIVIDEND REINVESTMENT PLAN *(Page 144)*

We maintain an opt in dividend reinvestment plan for our common shareholders. As a result, if our Board of Directors declares a dividend, then our shareholders that have not opted in to our dividend reinvestment plan will receive cash dividends. New shareholders must notify our transfer agent in writing if they wish to enroll in the dividend reinvestment plan.

RISK FACTORS *(Page 10)*

Investment in shares of our common stock involves a number of significant risks relating to our business and our investment objective that you should consider before purchasing shares of our common stock.

Substantially all of our portfolio of investments, which are generally illiquid, are recorded at fair value, as determined in good faith by our Board of Directors. Our portfolio includes securities primarily issued by private companies. These investments may involve a high degree of business and financial risk; they are illiquid, and may not produce current returns or capital gains. If we were forced to immediately liquidate some or all of the investments in the portfolio, the proceeds of such liquidation could be significantly less than the current value of such investments. We may be required to liquidate some or all of our portfolio investments to meet our debt service obligations or in the event we are required to fulfill our obligations under agreements pursuant to which we guarantee the repayment of indebtedness by third parties.

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

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

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

A large number of entities and individuals compete for the same kind of investment opportunities as we do. Increased competition would make it more difficult for us to purchase or originate investments at attractive prices. As a result of this competition, sometimes we may be precluded from making otherwise attractive investments.

Our business of making private equity investments and positioning them for liquidity events also may be affected by current and future market conditions.

To maintain our status as a business development company, we must not acquire any assets other than qualifying assets unless, at the time of and after giving effect to such acquisition, at least 70% of our total assets are qualifying assets.

We may not be able to pay dividends and failure to qualify as a regulated investment company for tax purposes could have a material adverse effect on the income available for debt service or distributions to our shareholders, which may have a material adverse effect on our total return to common shareholders, if any.

Although funds managed by us may have a different primary investment objective than we do, the managed funds may invest in the same or similar asset classes that we target. There may be conflicts in the allocation of the investment opportunities between us and the managed funds. We have sold assets to certain managed funds and, as part of our investment strategy, we may offer to sell additional assets to managed funds or we may purchase assets from managed funds. While assets may be sold or purchased at prices that are consistent with those that could be obtained from third parties in the marketplace, there is an inherent conflict of interest in such transactions between us and funds we manage.

Also, we are subject to certain risks associated with valuing our portfolio, changing interest rates, accessing additional capital, fluctuating financial results, operating in a regulated environment, and certain conflicts of interest.

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

CERTAIN ANTI-TAKEOVER PROVISIONS *(Page 147)*

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

FEES AND EXPENSES

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

Shareholder Transaction Expenses	
Sales load (as a percentage of offering price)[(1)]	%
Dividend reinvestment plan fees[(2)]	None
Annual Expenses (as a percentage of consolidated net assets attributable to common stock)[(3)]	
Expenses[(4)]	6.08%
Interest payments on borrowed funds[(5)]	5.68%
Acquired fund fees and expenses[(6)]	%
Total annual expenses[(7)(8)]	11.76%

Example

The following example, required by the SEC, demonstrates the projected dollar amount of total cumulative expenses that would be incurred over various periods with respect to a hypothetical investment in us. In calculating the following expense amounts, we assumed we would have no additional leverage and that our operating expenses would remain at the levels set forth in the table above. In the event that shares to which this prospectus relates are sold to or through underwriters, a corresponding prospectus supplement will restate this example to reflect the applicable sales load.

	1 Year	3 Years	5 Years	10 Years
You would pay the following expenses on a $1,000 investment, assuming a 5.0% annual return	$ 117	$ 345	$ 566	$ 1,089

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

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

(1) In the event that the shares of common stock to which this prospectus relates are sold to or through underwriters, a corresponding prospectus supplement will disclose the applicable sales load.

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

(3) Consolidated net assets attributable to common stock equals net assets (*i.e.*, total consolidated assets less total consolidated liabilities), which at March 31, 2008, was $2.8 billion.

(4) Expenses represent our estimated operating expenses for the year ending December 31, 2008, including income tax expense (benefit) including excise tax, excluding interest on indebtedness. This percentage for the year ended December 31, 2007, was 6.80%. See Management s Discussion and Analysis of Financial Condition and Results of

Operations, Management and Compensation of Executive Officers and Directors.

(5) The Interest payments on borrowed funds represents our estimated interest expense for the year ending December 31, 2008, including interest related to usage under our revolving line of credit and new debt issuances during the remainder of 2008. We had outstanding borrowings of $2.2 billion at March 31, 2008. See Risk Factors. This percentage for the year ended December 31, 2007, was 4.77%.

(6) See our Consolidated Statement of Investments as of March 31, 2008, on pages F-76 through F-92 for our investments in funds.

(7) Total annual expenses as a percentage of consolidated net assets attributable to common stock are higher than the total annual expenses percentage would be for a company that is not leveraged. We borrow money to leverage our net assets and increase our total assets. The SEC requires that Total annual expenses percentage be calculated as a percentage of *net* assets, rather than the total assets, including assets that have been funded with borrowed monies. If the Total annual expenses percentage were calculated instead as a percentage of consolidated total assets, our Total annual expenses would be 6.55% of consolidated total assets.

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

SELECTED CONDENSED CONSOLIDATED FINANCIAL DATA

You should read the condensed consolidated financial information below with the Consolidated Financial Statements and Notes thereto included herein. Financial information at and for the years ended December 31, 2007, 2006, 2005, 2004, and 2003, has been derived from our financial statements that were audited by KPMG LLP. Quarterly financial information is derived from unaudited financial data, but in the opinion of management, reflects all adjustments (consisting only of normal recurring adjustments) which are necessary to present fairly the results for such interim periods. Interim results at and for the three months ended March 31, 2008, are not necessarily indicative of the results that may be expected for the year ending December 31, 2008. **See Management s Discussion and Analysis of Financial Condition and Results of Operations and Senior Securities below for more information.**

(in thousands, except per share data)	At and for the Three Months Ended March 31, 2008	2007	At and for the Year Ended December 31, 2007	2006	2005	2004	2003
	(unaudited)						
Operating Data:							
Interest and related portfolio income:							
Interest and dividends	$ 134,660	$ 101,983	$ 417,576	$ 386,427	$ 317,153	$ 319,642	$ 290,719
Fees and other income	10,284	5,969	44,129	66,131	56,999	47,448	38,510
Total interest and related portfolio income	144,944	107,952	461,705	452,558	374,152	367,090	329,229
Expenses:							
Interest	37,560	30,288	132,080	100,600	77,352	75,650	77,233
Employee	22,652	21,928	89,155	92,902	78,300	53,739	36,945
Employee stock options[(1)]	4,195	3,661	35,233	15,599			
Administrative	9,019	13,224	50,580	39,005	69,713	34,686	22,387
Total operating expenses	73,426	69,101	307,048	248,106	225,365	164,075	136,565
Net investment income before income taxes	71,518	38,851	154,657	204,452	148,787	203,015	192,664
Income tax expense (benefit), including excise tax	1,969	(649)	13,624	15,221	11,561	2,057	(2,466)
Net investment income	69,549	39,500	141,033	189,231	137,226	200,958	195,130
Net realized and unrealized gains (losses):							
Net realized gains	3,143	27,666	268,513	533,301	273,496	117,240	75,347
	(113,404)	65,920	(256,243)	(477,409)	462,092	(68,712)	(78,466)

Net change in unrealized appreciation or depreciation							
Total net gains (losses)	(110,261)	93,586	12,270	55,892	735,588	48,528	(3,119)
Net increase (decrease) in net assets resulting from operations	$ (40,712)	$ 133,086	$ 153,303	$ 245,123	$ 872,814	$ 249,486	$ 192,011
Per Share:							
Diluted earnings (loss) per common share	$ (0.25)	$ 0.87	$ 0.99	$ 1.68	$ 6.36	$ 1.88	$ 1.62
Net investment income plus net realized gains per share(2)	$ 0.45	$ 0.44	$ 2.65	$ 4.96	$ 2.99	$ 2.40	$ 2.28
Dividends per common share(2)	$ 0.65	$ 0.63	$ 2.64	$ 2.47	$ 2.33	$ 2.30	$ 2.28
Weighted average common shares outstanding diluted	161,507	152,827	154,687	145,599	137,274	132,458	118,351

(in thousands, except per share data)	At and for the Three Months Ended March 31, 2008 (unaudited)	At and for the Year Ended December 31, 2007	2006	2005	2004	2003
Balance Sheet Data:						
Portfolio at value	$ 4,635,633	$ 4,780,521	$ 4,496,084	$ 3,606,355	$ 3,013,411	$ 2,584,599
Total assets	5,082,242	5,214,576	4,887,505	4,025,880	3,260,998	3,019,870
Total debt outstanding(3)	2,191,563	2,289,470	1,899,144	1,284,790	1,176,568	954,200
Undistributed (distributions in excess of) earnings	500,464	535,853	502,163	112,252	12,084	(13,401)
Shareholders equity	2,828,418	2,771,847	2,841,244	2,620,546	1,979,778	1,914,577
Shareholders equity per common share (net asset value)(4)	$ 16.99	$ 17.54	$ 19.12	$ 19.17	$ 14.87	$ 14.94
Common shares outstanding at end of period	166,472	158,002	148,575	136,697	133,099	128,118
Asset coverage ratio(5)	229%	221%	250%	309%	280%	322%
Debt to equity ratio	0.77	0.83	0.67	0.49	0.59	0.50
Other Data:						
Investments funded	$ 275,130	$ 1,845,973	$ 2,437,828	$ 1,675,773	$ 1,524,523	$ 931,450
Principal collections related to investment repayments or sales	264,777	1,211,550	1,055,347	1,503,388	909,189	788,328
Realized gains	32,740	400,510	557,470	343,061	267,702	94,305
Realized losses	(29,597)	(131,997)	(24,169)	(69,565)	(150,462)	(18,958)

(in thousands, except per share data)	2008 Qtr 1	2007 Qtr 4	Qtr 3	Qtr 2	Qtr 1	2006 Qtr 4	Qtr 3	Qtr 2	Qtr 1
Quarterly Data (unaudited):									
Total interest and related portfolio income	$144,944	$117,709	$118,368	$117,676	$107,952	$117,708	$113,383	$110,456	$111,011
Net investment income	69,549	58,040	18,318	25,175	39,500	49,078	48,658	50,195	41,300
Net increase (decrease) in net assets resulting from operations	(40,712)	27,527	(96,468)	89,158	133,086	33,921	77,886	33,729	99,587
	$(0.25)	$0.18	$(0.63)	$0.57	$0.87	$0.23	$0.53	$0.24	$0.70

Diluted earnings (loss) per common share									
Dividends declared per common share [6]	0.65	0.72	0.65	0.64	0.63	0.67	0.61	0.60	0.59
Net asset value per common share[4]	16.99	17.54	17.90	19.59	19.58	19.12	19.38	19.17	19.50

(1) Effective January 1, 2006, we adopted the provisions of Statement No. 123 (Revised 2004), *Share-Based Payment*. See Management s Discussion and Analysis of Financial Condition and Results of Operations below.

(2) Dividends are based on taxable income, which differs from income for financial reporting purposes. Net investment income and net realized gains are the most significant components of our annual taxable income from which dividends are paid. See Management s Discussion and Analysis of Financial Condition and Results of Operations and Dividends and Distributions below.

(3) See Senior Securities and Management s Discussion and Analysis of Financial Condition and Results of Operations for more information regarding our level of indebtedness.

(4) We determine net asset value per common share as of the last day of the period presented. The net asset values shown are based on outstanding shares at the end of each period presented.

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

(6) Dividends declared per common share for the fourth quarter of 2007 included the regular quarterly dividend of $0.65 per common share and an extra dividend of $0.07 per common share. Dividends declared per common share for the fourth quarter of 2006 included the regular quarterly dividend of $0.62 per common share and an extra dividend of $0.05 per common share.

WHERE YOU CAN FIND ADDITIONAL INFORMATION

We have filed with the SEC a registration statement on Form N-2 together with all amendments and related exhibits under the Securities Act of 1933. The registration statement contains additional information about us and the securities being offered by this prospectus.

We file annual, quarterly and current reports, proxy statements and other information with the SEC under the Securities Exchange Act of 1934. You can inspect any materials we file with the SEC, without charge, at the SEC s Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the Public Reference Room. The information we file with the SEC is available free of charge by contacting us at 1919 Pennsylvania Avenue, N.W., Washington, DC, 20006-3434, or by telephone at (202) 721-6100 or on our website at www.alliedcapital.com. The SEC also maintains a website that contains reports, proxy statements and other information regarding registrants, including us, that file such information electronically with the SEC. The address of the SEC s website is *www.sec.gov*. Information contained on our website or on the SEC s website about us is not incorporated into this prospectus and you should not consider information contained on our website or on the SEC s website to be part of this prospectus.

RISK FACTORS

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

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

Investing in private companies involves a high degree of risk. Our portfolio primarily consists of long-term loans to and investments in middle market private companies. Investments in private businesses involve a high degree of business and financial risk, which can result in substantial losses for us in those investments and accordingly should be considered speculative. There is generally no publicly available information about the companies in which we invest, and we rely significantly on the diligence of our employees and agents to obtain information in connection with our investment decisions. If we are unable to identify all material information about these companies, among other factors, we may fail to receive the expected return on our investment or lose some or all of the money invested in these companies. In addition, these businesses may have shorter operating histories, narrower product lines, smaller market shares and less experienced management than their competition and may be more vulnerable to customer preferences, market conditions, loss of key personnel, or economic downturns, which may adversely affect the return on, or the recovery of, our investment in such businesses. As an investor, we are subject to the risk that a portfolio company may make a business decision that does not serve our interest, which could decrease the value of our investment. Deterioration in a portfolio company s financial condition and prospects may be accompanied by deterioration in the collateral for a loan, if any.

Substantially all of our portfolio investments, which are generally illiquid, are recorded at fair value as determined in good faith by our Board of Directors and, as a result, there is uncertainty regarding the value of our portfolio investments. At March 31, 2008, portfolio investments recorded at fair value were 91% of our total assets. Pursuant to the requirements of the 1940 Act, we value substantially all of our investments at fair value as determined in good faith by our Board of Directors on a quarterly basis. Since there is typically no market quotation in an active market for the investments in our portfolio, our Board of Directors determines in good faith the fair value of these investments pursuant to a valuation policy and a consistently applied valuation process.

There is no single approach for determining fair value in good faith. As a result, determining fair value requires that judgment be applied to the specific facts and circumstances of each portfolio investment while employing a consistently applied valuation process for the types of investments we make. In determining fair value in good faith, we generally obtain financial and other information from portfolio companies, which may represent unaudited, projected or proforma financial information. Unlike banks, we are not permitted to provide a general reserve for anticipated loan losses; we are instead required by the 1940 Act to specifically value each individual investment on a quarterly basis. We will record unrealized depreciation on investments when we determine that the fair value of a security is less than its cost basis, and unrealized appreciation when we determine that the fair value of a security is greater than its cost basis. Without a market quotation in an active market and because of the inherent uncertainty of valuation, the fair value of our investments determined in good faith by the Board of Directors may differ significantly from the values that would have been used had a ready market existed for the investments, and the differences could be material. Our net asset value could be affected if our determination of the fair value of our investments is materially different than the value that we ultimately realize.

We adjust quarterly the valuation of our portfolio to reflect the Board of Directors determination of the fair value of each investment in our portfolio. Any changes in fair value are recorded in our statement of operations as net change in unrealized appreciation or depreciation.

Beginning in the quarter ended March 31, 2008, we adopted the provisions of Statement No. 157, *Fair Value Measurements*, on a prospective basis. Adoption of this statement did not have a material effect on our consolidated financial statements for the first quarter of 2008. However, the impact on our consolidated financial statements in the periods subsequent to the period of adoption cannot be determined at this time as it will be influenced by the estimates of fair value for those periods, the number and amount of investments we originate, acquire or exit and the effect of any additional guidance or any changes in the interpretation of this statement. See Note 2, Summary of Significant Accounting Policies from our Notes to the Consolidated Financial Statements.

Economic recessions or downturns could impair our portfolio companies and harm our operating results. Many of the companies in which we have made or will make investments may be susceptible to economic slowdowns or recessions. An economic slowdown may affect the ability of a company to repay our loans or engage in a liquidity event such as a sale, recapitalization, or initial public offering. Our nonperforming assets are likely to increase and the value of our portfolio is likely to decrease during these periods. Adverse economic conditions also may decrease the value of any collateral securing some of our loans. These conditions could lead to financial losses in our portfolio and a decrease in our revenues, net income, and assets.

Our business of making private equity investments and positioning them for liquidity events also may be affected by current and future market conditions. The absence of an active senior lending environment or a slowdown in middle market merger and acquisition activity may slow the amount of private equity investment activity generally. As a result, the pace of our investment activity may slow. In addition, significant changes in the capital markets could have a negative effect on the valuations of our investments, and on the potential for liquidity events involving such investments. This could affect the timing of exit events in our portfolio, reduce the level of net realized gains from exit events in a given year, and could negatively affect the amount of gains or losses upon exit.

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

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

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

At March 31, 2008, our investment in Ciena Capital LLC (Ciena) totaled $327.8 million at cost and $29.3 million at value, after the effect of unrealized depreciation of $298.5 million. In addition, we have an unconditional guarantee of 100% of the total obligations under Ciena s revolving credit facility that totaled $384.8 million at March 31, 2008. The guarantee can be called by the lenders in event of default. In addition, we have issued performance guarantees in connection with two non-recourse warehouse facilities. Ciena focuses on loan products that provide financing to commercial real estate owners and operators. Ciena relies on the asset-backed securitization market to finance its loan origination activity. That financing source continues to be unreliable in the current capital markets, and as a result, Ciena has substantially curtailed loan origination activity. Ciena continues to reposition its business; however, there is an inherent risk in repositioning the business and we continue to work with Ciena on restructuring. Our financial results could be negatively affected if Ciena defaults on its revolving line of credit or is not able to reposition its business.

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

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

At March 31, 2008, we had $2.2 billion of outstanding indebtedness bearing a weighted average annual interest cost of 6.2% and a debt to equity ratio of 0.77 to 1.00. We may incur additional debt in the future. If our portfolio of investments fails to produce adequate returns, we may be unable to make interest or principal payments on our indebtedness when they are due. In order for us to cover annual interest

payments on indebtedness, we must achieve annual returns on our assets of at least 2.7% as of March 31, 2008, which returns were achieved.

Illustration. The following table illustrates the effect of leverage on returns from an investment in our common stock assuming various annual returns, net of expenses. The calculations in the table below are hypothetical and actual returns may be higher or lower than those appearing below. The calculation assumes (i) $5,082.2 million in total assets, (ii) an average cost of funds of 6.2%, (iii) $2,191.6 million in debt outstanding and (iv) $2,828.4 million of shareholders equity.

	Assumed Return on Our Portfolio (net of expenses)						
	-20%	**-10%**	**-5%**	**0%**	**5%**	**10%**	**20%**
Corresponding return to shareholder	-40.74%	-22.77%	-13.79%	-4.80%	4.18%	13.16%	31.13%

We may not borrow money unless we maintain asset coverage for indebtedness of at least 200%, which may affect returns to shareholders. Under the 1940 Act and the covenants applicable to our public debt, we must maintain asset coverage for total borrowings of at least 200%. Our ability to achieve our investment objective may depend in part on our continued ability to maintain a leveraged capital structure by borrowing from banks, insurance companies or other lenders or investors on favorable terms. There can be no assurance that we will be able to maintain such leverage. If asset coverage declines to less than 200%, we may be required to sell a portion of our investments when it is disadvantageous to do so. As of March 31, 2008, our asset coverage for senior indebtedness was 229%.

Changes in interest rates may affect our cost of capital and net investment income. Because we borrow money to make investments, our net investment income is dependent upon the difference between the rate at which we borrow funds and the rate at which we invest these funds. As a result, there can be no assurance that a significant change in market interest rates will not have a material adverse effect on our net investment income. In periods of rising interest rates, our cost of funds would increase, which would reduce our net investment income. We use a combination of long-term and short-term borrowings and equity capital to finance our investing activities. We utilize our revolving line of credit as a means to bridge to long-term financing. Our long-term fixed-rate investments are financed primarily with long-term fixed-rate debt and equity. We may use interest rate risk management techniques in an effort to limit our exposure to interest rate fluctuations. Such techniques may include various interest rate hedging activities to the extent permitted by the 1940 Act. We have analyzed the potential impact of changes in interest rates on interest income net of interest expense.

Assuming that the balance sheet as of March 31, 2008, were to remain constant and no actions were taken to alter the existing interest rate sensitivity, a hypothetical immediate 1% change in interest rates would have affected net income by approximately 1% over a one year horizon. Although management believes that this measure is indicative of our sensitivity to interest rate changes, it does not adjust for potential changes in credit quality, size and composition of the assets on the balance sheet and other business developments that could affect net increase in net assets resulting from operations, or net income. Accordingly, no assurances can be given that actual results would not differ materially from the potential outcome simulated by this estimate.

We will continue to need additional capital to grow because we must distribute our income. We will continue to need capital to fund growth in our investments. Historically, we have borrowed from financial institutions or other investors and have issued debt and equity securities to grow our portfolio. A reduction in the availability of new debt or equity capital could limit our ability to grow. We must distribute at least 90% of our investment company taxable ordinary income (as defined in the Code), which excludes realized net long-term capital gains, to our shareholders to maintain our eligibility for the tax benefits available to regulated investment companies. As a result, such earnings will not be available to

fund investment originations. In addition, as a business development company, we (i) are generally required to maintain a ratio of at least 200% of total assets to total borrowings, which may restrict our ability to borrow in certain circumstances and (ii) may only issue new equity capital at a price, net of discounts and commissions, above our net asset value unless we have received shareholder approval. We intend to continue to borrow from financial institutions or other investors and issue additional debt and equity securities. If we fail to obtain funds from such sources or from other sources to fund our investments, it could limit our ability to grow, which could have a material adverse effect on the value of our debt securities or common stock.

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

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

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

There are potential conflicts of interest between us and the funds managed by us. Certain of our officers serve or may serve in an investment management capacity to funds managed by us. As a result, investment professionals may allocate such time and attention as is deemed appropriate and necessary to carry out the operations of the managed funds. In this respect, they may experience diversions of their attention from us and potential conflicts of interest between their work for us and their work for the managed funds in the event that the interests of the managed funds run counter to our interests.

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

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

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

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

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

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

Our common stock price may be volatile. The trading price of our common stock may fluctuate substantially. The price of the common stock may be higher or lower than the price paid by stockholders, depending on many factors, some of which are beyond our control and may not be directly related to our operating performance. These factors include, but are not limited to, the following:

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

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

- the time remaining to the maturity of these debt securities;
- the outstanding principal amount of debt securities with terms identical to these debt securities;
- the supply of debt securities trading in the secondary market, if any;
- the redemption or repayment features, if any, of these debt securities;
- the level, direction and volatility of market interest rates generally; and
- market rates of interest higher or lower than rates borne by the debt securities.

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

Our credit ratings may not reflect all risks of an investment in the debt securities. Our credit ratings are an assessment of our ability to pay our obligations. Consequently, real or anticipated changes in our credit ratings will generally affect the market value of the publicly issued debt securities. Our credit ratings, however, may not reflect the potential impact of risks related to market conditions generally or other factors discussed above on the market value of, or trading market for, the publicly issued debt securities.

Terms relating to redemption may materially adversely affect the return on the debt securities. If our debt securities are redeemable at our option, we may choose to redeem the debt securities at times when prevailing interest rates are lower than the interest rate paid on the debt securities. In addition, if the debt securities are subject to mandatory redemption, we may be required to redeem the debt securities at times when prevailing interest rates are lower than the interest rate paid on the debt securities. In this circumstance, a holder of the debt securities may not be able to reinvest the redemption proceeds in a comparable security at an effective interest rate as high as the debt securities being redeemed.

Disclosure Regarding Forward-Looking Statements

Information contained or incorporated by reference in this prospectus, and any prospectus supplement accompanying this prospectus contains forward-looking statements. These statements include the plans and objectives of management for future operations and financial objectives and can be identified by the use of forward-looking terminology such as may, will, expect, intend, anticipate, estimate or continue or the negative thereof or ot variations thereon or comparable terminology. These forward-looking statements are subject to the inherent uncertainties in predicting future results and conditions. Certain factors that could cause actual results and conditions to differ materially from those projected in these forward-looking statements are set forth above in the Risk Factors section. Other factors that could cause actual results to differ materially include:

changes in the economy, including economic downturns or recessions;

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

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

other risks and uncertainties as may be detailed from time to time in our public announcements and SEC filings.

The matters described in Risk Factors and certain other factors noted throughout this prospectus, and any prospectus supplement accompanying this prospectus and in any exhibits to the registration statement of which this prospectus is a part, constitute cautionary statements identifying important factors with respect to any such forward-looking statements, including certain risks and uncertainties, that could cause actual results to differ materially from those in such forward-looking statements.

Although we believe that the assumptions on which these forward-looking statements are based are reasonable, any of those assumptions could prove to be inaccurate, and as a result, the forward-looking statements based on those assumptions also could be incorrect. Important assumptions include our ability to originate new investments, maintain certain margins and levels of profitability, access the capital markets for debt and equity capital, the ability to meet regulatory requirements and the ability to maintain certain debt to asset ratios. In light of these and other uncertainties, the inclusion of a projection or forward-looking statement in this prospectus and any prospectus supplement accompanying this prospectus should not be regarded as a representation by us that our plans and objectives will be achieved. You should not place undue reliance on these forward-looking statements, which apply only as of the date of this prospectus and the date on the cover of any such supplements with respect to such supplements. The forward-looking statements contained in this prospectus and any accompanying prospectus supplement are excluded from the safe harbor protection provided by Section 27A of the Securities Act of 1933.

USE OF PROCEEDS

We intend to use the net proceeds from selling shares of our common stock for general corporate purposes, which may include investing in debt or equity securities in primarily privately negotiated transactions, repayment of indebtedness, acquisitions and other general corporate purposes. Because our primary business is to provide long-term debt and equity capital to primarily middle market companies, we are continuously identifying, reviewing and, to the extent consistent with our investment objective, funding new investments. As a result, we typically raise capital as we deem appropriate to fund such new investments. Any supplement to this prospectus relating to an offering will more fully identify the use of the proceeds from such offering.

We anticipate that substantially all of the net proceeds of any offering of shares of our common stock will be used, as described above or in any prospectus supplement accompanying this prospectus, within six months, but in no event longer than two years. Pending investment, we intend to invest the net proceeds of any offering of shares of our common stock in time deposits, income-producing securities with maturities of three months or less that are issued or guaranteed by the federal government or an agency of the federal government, high quality debt securities maturing in one year or less from the time of investment or other qualifying investments. Our ability to achieve our investment objective may be limited to the extent that the net proceeds of any offering, pending full investment, are held in lower-yielding time deposits and other short-term instruments.

PRICE RANGE OF COMMON STOCK AND DISTRIBUTIONS

Our common stock is traded on the New York Stock Exchange and the Nasdaq Global Select Market under the symbol ALD. The following table lists the high and low closing sales prices for our common stock, the closing sales price as a percentage of net asset value (NAV) and quarterly dividends per share. On May 12, 2008, the last reported closing sale price of our common stock was $21.26 per share.

	NAV[1]	Closing Sales Price High	Closing Sales Price Low	Premium of High Sales Price to NAV[2]	Premium of Low Sales Price to NAV[2]	Declared Dividends
Year ended December 31, 2006						
First Quarter	$ 19.50	$ 30.68	$ 28.51	157%	146%	$ 0.59
Second Quarter	$ 19.17	$ 31.32	$ 28.77	163%	150%	$ 0.60
Third Quarter	$ 19.38	$ 30.88	$ 27.30	159%	141%	$ 0.61
Fourth Quarter	$ 19.12	$ 32.70	$ 29.99	171%	157%	$ 0.62
Extra Dividend						$ 0.05
Year ended December 31, 2007						
First Quarter	$ 19.58	$ 32.98	$ 28.05	168%	143%	$ 0.63
Second Quarter	$ 19.59	$ 32.96	$ 28.90	168%	148%	$ 0.64
Third Quarter	$ 17.90	$ 32.87	$ 27.10	184%	151%	$ 0.65
Fourth Quarter	$ 17.54	$ 30.90	$ 21.15	176%	121%	$ 0.65
Extra Dividend						$ 0.07
Year ended December 31, 2008						
First Quarter	$ 16.99	$ 23.26	$ 18.38	137%	108%	$ 0.65
Second Quarter (through May 12, 2008)	*	$ 21.26	$ 18.80	*	*	$ 0.65

(1) Net asset value per share is determined as of the last day in the relevant quarter and therefore may not reflect the net asset value per share on the date of the high and low sales prices. The net asset values shown are based on outstanding shares at the end of each period.

(2) Calculated as the respective high or low closing sales price divided by NAV.

* Not determinable at the time of filing.

Shares of business development companies may trade at a market price that is less than the value of the net assets attributable to those shares. Our common stock currently continues to trade in excess of net asset value. The possibility that our shares of common stock will trade at a discount from net asset value or at premiums that are unsustainable over the long term is separate and distinct from the risk that our net asset value will decrease. There can be no assurance, however, that our shares will continue to trade at a premium to our net asset value.

We are not generally able to issue and sell our common stock at a price below net asset value per share. We may, however, sell our common stock, or sell warrants, options or rights to acquire such common stock, at a price below the current net asset value of the common stock if our board of directors determines that such sale is in our best interests and the best interests of our stockholders, and our stockholders approve our policy and practice of making such sales. In any such case, the price at which our securities are to be issued and sold may not be less than a price which, in the determination of our board of directors, closely approximates the market value of such securities (less any distributing commission or discount).

We intend to pay quarterly dividends to shareholders of our common stock. The amount of our quarterly dividends is determined by our Board of Directors. Our Board of Directors has established a dividend policy to review the dividend rate quarterly, and may adjust the quarterly dividend rate throughout the year. See Management s Discussion and Analysis of Financial Condition and Results of Operations Dividends and Distributions and Tax Status. There can be no assurance that we will achieve investment results or maintain a tax status that will permit any particular level of dividend payment. Certain of our credit facilities limit our ability to declare dividends if we default under certain provisions.

We maintain an opt in dividend reinvestment plan for our common shareholders. As a result, if our Board of Directors declares a dividend, then our shareholders will receive cash dividends, unless they specifically opt in to the dividend reinvestment plan to reinvest their dividends and receive additional shares of common stock. See Dividend Reinvestment Plan.

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

The information contained in this section should be read in conjunction with our Consolidated Financial Statements and the Notes thereto.

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

OVERVIEW

As a business development company, we are in the private equity business. Specifically, we provide long-term debt and equity investment capital to companies in a variety of industries. Our private finance activity principally involves providing financing to middle market U.S. companies through privately negotiated long-term debt and equity investment capital. Our financing is generally used to fund buyouts, acquisitions, growth, recapitalizations, note purchases, and other types of financings. We generally invest in private companies though, from time to time, we may invest in companies that are public but lack access to additional public capital. Our investment objective is to achieve current income and capital gains.

Our portfolio composition at March 31, 2008 and 2007, and at December 31, 2007, 2006, and 2005, was as follows:

	March 31,		December 31,		
	2008	2007	2007	2006	2005
Private finance	98%	97%	97%	97%	96%
Commercial real estate finance	2%	3%	3%	3%	4%

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

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

PORTFOLIO AND INVESTMENT ACTIVITY

The total portfolio at value, investment activity, and the yield on interest-bearing investments at and for the three months ended March 31, 2008 and 2007, and at and for the years ended December 31, 2007, 2006, and 2005, were as follows:

	At and for the Three Months Ended March 31,		At and for the Years Ended December 31,		
	2008	**2007**	**2007**	**2006**	**2005**
($ in millions)					
Portfolio at value	$ 4,635.6	$ 4,498.8	$ 4,780.5	$ 4,496.1	$ 3,606.4
Investments funded[1]	$ 275.1	$ 170.2	$ 1,846.0	$ 2,437.8	$ 1,675.8
Payment-in-kind or reinvested interest and dividends, net of collection	$ 13.4	$ 8.1	$ 12.0	$ 7.3	$ 25.7
Principal collections related to investment repayments or sales[2]	$ 264.8	$ 235.5	$ 1,211.6	$ 1,055.3	$ 1,503.4
Yield on interest-bearing investments[3]	12.3%	11.6%	12.1%	11.9%	12.8%

(1) Investments funded included investments acquired through the issuance of our common stock as consideration totaling $7.2 million for the year ended December 31, 2005. See also Private Finance below.

(2) Principal collections related to investment repayments or sales for the three months ended March 31, 2008, and for the year ended December 31, 2007, included collections of $30.0 million and $224.2 million, respectively, related to the sale of loans to the Allied Capital Senior Debt Fund, L.P. See discussion below.

(3) The weighted average yield on interest-bearing investments is computed as the (a) annual stated interest on accruing loans and debt securities plus the annual amortization of loan origination fees, original issue discount, and market discount on accruing loans and debt securities less the annual amortization of loan origination costs, plus the effective interest yield on the preferred shares/income notes of CLOs, plus the annual stated interest (LIBOR plus 7.5%) on the subordinated certificates in the Unitranche Fund LLC divided by (b) total interest-bearing investments at value. The weighted average yield is computed as of the balance sheet date.

Private Finance

The private finance portfolio at value, investment activity, and the yield on loans and debt securities at and for the three months ended March 31, 2008 and 2007, and at and for the years ended December 31, 2007, 2006, and 2005, were as follows:

	At and for Three Months Ended March 31,				At and for the Years Ended December 31,					
	2008		2007		2007		2006		2005	
($ in millions)	Value	Yield(1)	Value	Yield(1)	Value	Yield(1)	Value	Yield(1)	Value	Yield(1)
Portfolio at value:										
Loans and debt securities:										
Senior loans	$ 325.7	7.0%	$ 365,0	8.4%	$ 344.3	7.7%	$ 405.2	8.4%	$ 239.8	9.5%
Unitranche debt	655.7	11.8%	780.2	11.4%	653.9	11.5%	799.2	11.2%	294.2	11.4%
Subordinated debt	2,430.4	13.0%	1,946.1	12.5%	2,416.4	12.8%	1,980.8	12.9%	1,560.9	13.8%
Total loans and debt securities	3,411.8	12.2%	3,091.3	11.7%	3,414.6	12.1%	3,185.2	11.9%	2,094.9	13.0%
Equity securities:										
Preferred shares/income notes of CLOs(2)	197.4	15.8%	96.1	13.5%	203.0	14.6%	97.2	15.5%	72.3	13.7%
Subordinated certificates in Unitranche Fund LLC(2)	31.5	12.4%			0.7	12.4%				
Other equity securities	879.1		1,188.9		1,041.0		1,095.5		1,312.1	
Total equity securities	1,108.0		1,285.0		1,244.7		1,192.7		1,384.4	
Total portfolio	$ 4,519.8		$ 4,376.3		$ 4,659.3		$ 4,377.9		$ 3,479.3	

Investments funded[3]	$ 274.6	$ 170.2	$ $1,828.0	$ 2,423.4	$ 1,462.3
Payment-in-kind interest and dividends, net of collections	$ 13.2	$ 5.3	$ 12.7	$ 3.4	$ 25.7
Principal collections related to investment repayments or sales[4]	$ 256.4	$ 235.1	$ 1,188.2	$ 1,015.4	$ 703.9

(1) The weighted average yield on loans and debt securities is computed as the (a) annual stated interest on accruing loans and debt securities plus the annual amortization of loan origination fees, original issue discount, and market discount on accruing loans and debt securities less the annual amortization of loan origination costs, divided by (b) total loans and debt securities at value. The weighted average yield on the preferred shares/income notes of CLOs is calculated as the (a) effective interest yield on the preferred shares/income notes of CLOs, divided by (b) preferred shares/income notes of CLOs at value. The weighted average yield on the subordinated certificates in the Unitranche Fund LLC is computed as the (a) annual stated interest (LIBOR plus 7.5%) divided by (b) total investment at value. The weighted average yields are computed as of the balance sheet date.

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

(3) Investments funded for the year ended December 31, 2006, included debt investments in certain portfolio companies received in conjunction with the sale of such companies. See Private Finance - Investments Funded below.

(4) Includes collections from the sale or repayment of senior loans totaling $48.6 million, $94.7 million, $393.4 million, $322.7 million, and $301.8 million for the three months ended March 31, 2008 and 2007, and for the years ended December 31, 2007, 2006, and 2005, respectively.

Our investment activity is primarily focused on making long-term investments in the debt and equity of primarily private middle market companies. Debt investments may include senior loans, unitranche debt (an investment that combines both senior and subordinated financing, generally in a first lien position), or subordinated debt (with or without equity features). The junior debt that we invest in that is lower in repayment priority than senior debt is also known as mezzanine debt. Equity investments may include a minority equity stake in connection with a debt investment or a substantial equity stake in connection with a buyout transaction. In a buyout transaction, we generally invest in senior and/or subordinated debt and equity (preferred and/or voting or non-voting common) where our equity ownership represents a significant portion of the equity, but may or may not represent a controlling interest.

We intend to take a balanced approach to private equity investing that emphasizes a complementary mix of debt investments and buyout investments. The combination of these two types of investments provides current interest and related portfolio income and the potential for future capital gains. In addition, we may invest in funds that are managed or co-managed by us that are complementary to our business of investing in middle market companies, such as the Allied Capital Senior Debt Fund L.P. and the Unitranche Fund LLC. Investments in funds may provide current interest and related portfolio income, including management fees.

During the first six months of 2007, we found it difficult to find investments with attractive prices and structures. As a result, new investment activity was lower than in prior quarters. During the second half of 2007 and into the first quarter of 2008, our investment pace increased as pricing and structures improved. In the first quarter of 2008, we invested 274.6 million in private finance as compared to $170.2 million in the first quarter of 2007.

The level of investment activity for investments funded and principal repayments for private finance investments can vary substantially from period to period depending on the number and size of investments that we make or that we exit and many other factors, including the amount of debt and equity capital available to middle market companies, the level of merger and acquisition activity for such companies, the general economic environment, and the competitive environment for the types of investments we make.

Investments Funded. Investments funded and the weighted average yield on loans and debt securities funded for the three months ended March 31, 2008 and 2007, and for the years ended December 31, 2007, 2006, and 2005, consisted of the following:

For the Three Months Ended March 31, 2008

	Debt Investments		Buyout Investments		Total	
($ in millions)	**Amount**	**Weighted Average Yield(1)**	**Amount**	**Weighted Average Yield(1)**	**Amount**	**Weighted Average Yield(1)**
Loans and debt securities:						
Senior loans	$ 26.8	7.4%	$ 10.4	6.7%	$ 37.2	7.2%
Unitranche debt(2)	4.5	10.3%	0.5	6.6%	5.0	9.9%
Subordinated debt	129.9(4)	12.0%	31.3	14.2%	161.2	12.4%
Total loans and debt securities	161.2	11.2%	42.2	12.3%	203.4	11.4%
Preferred shares/income notes of CLOs (5)	3.0	27.6%			3.0	27.6%
Subordinated certificates in Unitranche Fund LLC	30.7	12.4%			30.7	12.4%
Equity	13.6		23.9		37.5	
Total	$ 208.5		$ 66.1		$ 274.6	

For the Three Months Ended March 31, 2007

	Debt Investments		Buyout Investments		Total	
($ in millions)	**Amount**	**Weighted Average Yield(1)**	**Amount**	**Weighted Average Yield(1)**	**Amount**	**Weighted Average Yield(1)**
Loans and debt securities:						
Senior loans	$ 41.2	8.8%	$ 12.7	10.4%	$ 53.9	9.2%
Unitranche debt(2)	5.3	11.0%			5.3	11.0%
Subordinated debt	14.4	9.3%	62.1	10.5%	76.5	10.3%
Total loans and debt securities	60.9	9.1%	74.8	10.5%	135.7	9.9%
Equity	9.7		24.8		34.5	
Total	$ 70.6		$ 99.6		$ 170.2	

	2007 Investments Funded					
	Debt Investments		Buyout Investments		Total	
($ in millions)	Amount	Weighted Average Yield(1)	Amount	Weighted Average Yield(1)	Amount	Weighted Average Yield(1)
Loans and debt securities:						
Senior loans	$ 249.0	9.2%	$ 63.1	8.8%	$ 312.1	9.1%
Unitranche debt(2)	109.1	10.8%	74.9	13.0%	184.0	11.7%
Subordinated debt	719.4(4)	12.8%	197.6	12.1%	917.0	12.6%
Total loans and debt securities	1,077.5	11.7%	335.6	11.7%	1,413.1	11.7%
Preferred shares/income notes of CLOs (5)	116.2	16.4%			116.2	16.4%
Subordinated certificates in Unitranche Fund LLC	0.7	12.4%			0.7	12.4%
Equity	152.0(6)		146.0		298.0	
Total	$ 1,346.4		$ 481.6		$ 1,828.0	

($ in millions)	2006 Investments Funded					
	Debt Investments		Buyout Investments		Total	
	Amount	Weighted Average Yield(1)	Amount	Weighted Average Yield(1)	Amount	Weighted Average Yield(1)
Loans and debt securities:						
Senior loans	$ 245.4	9.4%	$ 239.8	8.9%	$ 485.2	9.2%
Unitranche debt(2)	471.7	10.7%	146.5	12.9%	618.2	11.3%
Subordinated debt(3)	510.7	13.0%	423.8	14.4%	934.5	13.6%
Total loans and debt securities	1,227.8	11.4%	810.1	12.5%	2,037.9	11.9%
Preferred shares/income notes of CLOs (5)	26.1	14.8%			26.1	14.8%
Equity	65.3		294.1		359.4	
Total	$ 1,319.2		$ 1,104.2		$ 2,423.4	

($ in millions)	2005 Investments Funded					
	Debt Investments		Buyout Investments		Total	
	Amount	Weighted Average Yield(1)	Amount	Weighted Average Yield(1)	Amount	Weighted Average Yield(1)
Loans and debt securities:						
Senior loans	$ 76.8	10.0%	$ 250.2	6.4%	$ 327.0	7.2%
Unitranche debt(2)	259.5	10.5%			259.5	10.5%
Subordinated debt	296.9(4)	12.3%	330.9	12.5%	627.8	12.4%
Total loans and debt securities	633.2	11.3%	581.1	9.9%	1,214.3	10.6%
Preferred shares/income notes of CLOs(5)	47.9	14.2%			47.9	14.2%
Equity	34.6		165.5		200.1	
Total	$ 715.7		$ 746.6		$ 1,462.3	

(1) The weighted average yield on interest-bearing investments is computed as the (a) annual stated interest on accruing interest-bearing investments, divided by (b) total interest-bearing investments funded. The weighted average yield on the preferred shares/income notes of CLOs is calculated as the (a) effective interest yield on the preferred shares/income notes of CLOs, divided by (b) preferred shares/income notes of CLOs funded. The weighted average yield on the subordinated certificates in the Unitranche Fund LLC is computed as the (a) annual stated interest (LIBOR plus 7.5%) divided by (b) total investment at value. The weighted average yield is calculated using yields as of the date an investment is funded.

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

(3) Debt investments funded for the year ended December 31, 2006, included a $150 million subordinated debt investment in Advantage Sales & Marketing, Inc. received in conjunction with the sale of Advantage and a $30 million subordinated debt investment in STS Operating, Inc. received in conjunction with the sale of STS.

(4) Subordinated debt investments for the three months ended March 31, 2008, and the years ended December 31, 2007 and 2005, included $2.0 million, $45.3 million and $45.5 million, respectively, in investments in the bonds of collateralized loan obligations (CLOs) and one collateralized debt obligations (CDO). Certain of these CLOs and the CDO are managed by Callidus Capital Corporation (Callidus), a portfolio company controlled by us. These CLOs and the CDO primarily invest in senior corporate loans.

(5) CLO equity investments included preferred shares/income notes of CLOs that primarily invest in senior corporate loans. Certain of these CLOs are managed by Callidus.

(6) Equity investments for the year ended December 31, 2007, included $31.8 million invested in the Allied Capital Senior Debt Fund, L.P. See Managed Funds below.

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

We may underwrite or arrange senior loans related to our portfolio investments or for other companies that are not in our portfolio. When we underwrite or arrange senior loans, we may earn a fee for such activities. Senior loans underwritten or arranged by us may be funded by us at closing. When these senior loans are closed, we may fund all or a portion of the underwritten commitment pending sale of the loan to other investors, which may include loan sales to Callidus Capital Corporation (Callidus), a portfolio company controlled by us, or funds managed by Callidus or by us, including the Allied Capital Senior Debt Fund, L.P. (discussed below). After completion of loan sales, we may retain a position in these senior loans. We generally earn a fee on the senior loans we underwrite or arrange whether or not we fund the underwritten commitment. In addition, we may fund most or all of the debt and equity capital upon the closing of certain buyout transactions, which may include investments in lower-yielding senior debt. Subsequent to the closing, the portfolio company may refinance all or a portion of the lower-yielding senior debt, which would reduce our investment. Principal collections include repayments of senior debt funded by us that was subsequently sold by us or refinanced or repaid by the portfolio companies.

We are currently focused on selling or encouraging the recapitalization or refinancing of some of our lower yielding debt investments. We may sell loans or debt securities to Managed Funds or portfolio companies may refinance their debt through a Managed Fund.

Yield. The weighted average yield on the private finance loans and debt securities was 12.2% at March 31, 2008, as compared to 11.7%, 12.1%, 11.9% and 13.0% at March 31, 2007, December 31, 2007, 2006 and 2005, respectively. The weighted average yield on the private finance loans and debt securities may fluctuate from period to period depending on the yield on new loans and debt securities funded, the yield on loans and debt securities repaid, the amount of loans and debt securities for which interest is not accruing (see Portfolio Asset Quality Loans and Debt Securities on Non-Accrual Status below) and the amount of lower-yielding senior or unitranche debt in the portfolio at the end of the period.

The yield on the private finance portfolio declined in 2006 and 2007 partly due to our strategy to pursue investments where our position in the portfolio company capital structure is more senior, such as senior debt and unitranche investments that typically have lower yields than subordinated debt investments. In addition, during the fourth quarter of 2006, the guaranteed dividend yield on our investment in Ciena Capital LLC s 25% Class A equity interests was placed on non-accrual status. The Class A equity interests are included in our loans and debt securities. See Ciena Capital LLC below.

Outstanding Investment Commitments. At March 31, 2008, we had outstanding private finance investment commitments as follows:

($ in millions)	Companies More Than 25% Owned[(1)]	Companies 5% to 25% Owned	Companies Less Than 5% Owned	Total
Senior loans	$ 8.6	$ 12.0	$ 98.5	$ 119.1[(2)]
Unitranche debt	3.0		44.6	47.6
Subordinated debt	23.0	4.3		27.3
Total loans and debt securities	34.6	16.3	143.1	194.0
Unitranche Fund[(3)]	493.5			493.5
Equity securities	91.7	9.8	56.3	157.8[(4)]
Total	$ 619.8	$ 26.1	$ 199.4	$ 845.3

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

($ in millions)	Committed Amount	Amount Drawn	Amount Available to be Drawn
Revolving line of credit for working capital	$ 4.0	$ 1.6	$ 2.4
Subordinated debt to support warehouse facilities & warehousing activities[(*)]	18.0	4.0	14.0
Total	$ 22.0	$ 5.6	$ 16.4

(*) Callidus has a synthetic credit facility with a third party for up to approximately $55 million. We have agreed to designate our subordinated debt commitment for Callidus to draw upon to provide first loss capital as needed to support this facility.

(2) Includes $113.2 million in the form of revolving senior debt facilities to 33 companies.

(3) Represents our commitment to the Unitranche Fund LLC (see discussion below), which we estimate will be funded over a two to three year period as investments are made by the Unitranche Fund.

(4)

Includes $66.1 million to 13 private equity and venture capital funds, including $3.9 million in co-investment commitments to one private equity fund.

In addition to these outstanding investment commitments at March 31, 2008, we may be required to fund additional amounts under earn-out arrangements primarily related to buyout transactions in the future if those companies meet agreed-upon performance targets. We also had commitments to private finance portfolio companies in the form of standby letters of credit and guarantees. See Financial Condition, Liquidity and Capital Resources below.

Investments in Collateralized Loan Obligations and Collateralized Debt Obligations (CLO/CDO Assets). At both March 31, 2008, and December 31, 2007, we had investments in ten CLO issuances and one CDO bond, which represented 5.7% and 5.6% of our total assets, respectively, and five CLO issuances and one CDO bond, which represented 2.9% of our total assets, at December 31, 2006. At March 31, 2008, and at December 31, 2007 and 2006, our CLO/CDO Assets were as follows:

	2008			**2007**			**2006**		
($ in millions)	**Cost**	**Value**	**Yield(1)**	**Cost**	**Value**	**Yield(1)**	**Cost**	**Value**	**Yield(1)**
CLO/CDO bonds	$ 92.7	$ 92.1	12.7%	$ 90.7	$ 89.9	13.3%	$ 45.4	$ 45.6	12.8%
Preferred shares/income notes of CLOs	224.1	197.4	15.8%	218.3	203.0	14.6%	101.1	97.2	15.5%
Total	$ 316.8	$ 289.5		$ 309.0	$ 292.9		$ 146.5	$ 142.8	

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

The CLO and CDO issuances in which we have invested are primarily invested in senior corporate loans. See also Note 3, Portfolio from our Notes to the Consolidated Financial Statements.

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 CLOs and CDO in which we invest are invested primarily in first lien loans to corporate borrowers. We are not an investor in CLOs and CDO that hold subprime residential real estate loans. The CLO/CDO Assets in which we have invested are junior in priority for payment of interest and principal to the more senior notes issued by the CLOs and CDO. Cash flow from the underlying collateral assets in the CLOs and CDO is generally allocated first to the senior bonds in order of priority, then any remaining cash flow is generally distributed to the preferred shareholders and income note holders. To the extent there are defaults and unrecoverable losses on the underlying collateral assets that result in reduced cash flows, the preferred shares/income notes will bear this loss first and then the subordinated bonds would bear any loss after the preferred shares/income notes. At March 31, 2008, and December 31, 2007 and 2006, the face value of the CLO/CDO Assets held by us was subordinate to as much as 94%, 94% and 92%, respectively, of the face value of the securities outstanding in these CLOs and CDO.

At March 31, 2008, and December 31, 2007 and 2006, the underlying collateral assets of these CLO and CDO issuances, consisting primarily of senior corporate loans, were issued by 636 issuers, 671 issuers and 465 issuers, respectively, and had balances as follows:

($ in millions)	2008	2007	2006
Bonds	$ 286.1	$ 288.5	$ 245.4
Syndicated loans	4,206.5	4,122.7	1,769.9
Cash(1)	101.4	104.4	59.5
Total underlying collateral assets(2)	$ 4,594.0	$ 4,515.6	$ 2,074.8

(1) Includes undrawn liability amounts.

(2) At March 31, 2008, and December 31, 2007 and 2006, the total face value of defaulted obligations was $42.3 million, $18.4 million and $9.6 million, respectively, or approximately 0.9%, 0.4% and 0.5%, respectively, of the total underlying collateral assets.

Since the third quarter of 2007, the debt capital markets have been volatile and market yields for CLO securities have increased. We believe the market yields for our investments in CLO preferred shares/income notes have increased, and as a result, the fair value of certain of our investments in these assets has decreased. At March 31, 2008, the market yields used to value our preferred shares/income notes were 22% to 23%, with the exception of the income notes in one CLO with a cost and value of $23.1 million where we used a market yield of 18% due to the characteristics of the issuance. At December 31, 2007, the market yields used to value our preferred shares/income notes were 20% to 21%, with the exception of the income notes in one CLO with a cost and value of $18.7 million where we used a market yield of 15.9% and one CLO with a cost and value of $22.1 million where we used a market yield of 18% due to the characteristics of these issuances. Net change in unrealized appreciation or depreciation for the three months ended March 31, 2008, and for the year ended December 31, 2007,

included a net decrease of $11.2 million and $12.4 million, respectively, related to our investments in CLO/CDO Assets. We received valuation assistance for our investments in the CLO/CDO Assets in each quarter of 2007 and in the first quarter of 2008. See Results of Operations Valuation Methodology Private Finance below for further discussion of the third-party valuation assistance we received.

Ciena Capital LLC. Ciena Capital LLC (f/k/a Business Loan Express, LLC) (Ciena) focuses on loan products that provide financing to commercial real estate owners and operators. Ciena is also a participant in the SBA s 7(a) Guaranteed Loan Program and its wholly-owned subsidiary is licensed by the SBA as a Small Business Lending Company (SBLC). Ciena is headquartered in New York, NY and maintains offices in other U.S. locations. We invested in Ciena in 2000.

At March 31, 2008, our investment in Ciena totaled $327.8 million at cost and $29.3 million at value, after the effect or unrealized depreciation of $298.5 million. See Results of Operations, Valuation of Ciena Capital LLC for a discussion of the determination of the value of Ciena at March 31, 2008. At December 31, 2007, our investment in Ciena totaled $327.8 million at cost and $68.6 million at value, after the effect of unrealized depreciation of $259.2 million. In 2007, we increased our investment in Ciena by $32.4 million. We acquired $29.2 million in additional Class A equity interests to fund payments to the SBA discussed below and to provide additional capital to Ciena. In addition, we purchased $3.2 million in Class A equity interests from Ciena s former Chief Executive Officer. At December 31, 2006, our investment in Ciena totaled $295.3 million at cost and $210.7 million at value, after the effect of unrealized depreciation of $84.6 million.

Net change in unrealized appreciation or depreciation included a net decrease on our investment in Ciena of $39.3 million, $174.5 million and $142.3 million for the three months ended March 31, 2008, and for the years ended December 31, 2007 and 2006, respectively, and a net increase of $2.9 million for the year ended December 31, 2005. See Results of Operations, Valuation of Ciena Capital LLC below.

Total interest and related portfolio income earned from our investment in Ciena for the three months ended March 31, 2008, and 2007, and for the years ended December 31, 2007, 2006, and 2005, was as follows:

	Three Months Ended March 31,		**Year Ended**		
($ in millions)	**2008**	**2007**	**2007**	**2006**	**2005**
Interest income on subordinated debt and Class A equity interests[1]	$	$	$	$ 11.9	$ 14.3
Dividend income on Class B equity interests[1]					14.0
Fees and other income		1.4	5.4	7.8	9.2
Total interest and related portfolio income	$	$ 1.4	$ 5.4	$ 19.7	$ 37.5

[1] Interest and dividend income from Ciena for the years ended December 31, 2006 and 2005, included interest and dividend income of $5.7 million and $8.9 million, respectively, which was paid in kind. The interest and dividends paid in kind were paid to us through the issuance of additional debt or equity interests.

In the fourth quarter of 2006, we placed our investment in Ciena s 25% Class A equity interests on non-accrual status. As a result, there was no interest income from our investment in Ciena for the three months ended March 31, 2008 and 2007, and for the year ended December 31, 2007, and interest income for 2006 was lower as compared to 2005. In consideration for providing a guaranty on Ciena s revolving credit facility and standby letters of credit (discussed below), we earned fees of $1.4 million, $5.4 million, $6.1 million, and $6.3 million for the three months ended March 31, 2007 and for the years ended December 31, 2007, 2006, and 2005, respectively, which were included in fees and other income. Ciena has not yet paid the $5.4 million in such fees earned by us in 2007. At both March 31, 2008 and at December 31, 2007, such fees were included as a receivable in other assets. We considered this outstanding receivable in our valuation of Ciena at March 31, 2008, and at December 31, 2007. We did not accrue the fees earned from Ciena for providing the guaranty and standby letters of credit for the three months ended March 31, 2008. The remaining fees and other income in 2006 and 2005 relate to management fees from Ciena. We did not charge Ciena management fees in the first quarter of 2008, in 2007 or in the fourth quarter of 2006.

We guarantee Ciena s revolving credit facility that matures in March 2009. On January 30, 2008, Ciena completed an amendment of the terms of its revolving credit facility. The amendment reduced the commitments from the lenders under the facility from $500 million to $450 million at the effective date of the amendment, with further periodic reductions in total commitments to $325 million by December 31, 2008. In addition, certain financial and other covenants were amended. In connection with this amendment, we increased our unconditional guarantee from 60% to 100% of the total obligations under this facility (consisting of principal, letters of credit issued under the facility, accrued interest, and other fees) and replaced $42.5 million in letters of credit issued under the Ciena credit facility with new letters of credit under our revolving line of credit. The guaranty of the Ciena revolving credit facility can be called by the lenders in the event of a default, which includes the occurrence of any event of default under our revolving credit facility, subject to grace periods in certain cases. The amendment also prohibits cash payments from Ciena to us for interest, guarantee fees, management fees, and dividends. At March 31, 2008, the principal amount outstanding on Ciena s revolving credit facility was $335.0 million and letters of credit issued under the facility were $46.9 million. The total obligation guaranteed by us at March 31, 2008, was $384.8 million. At March 31, 2008, we had provided standby letters of credit totaling $59.5 million in connection with term securitizations completed by Ciena. At December 31, 2007, the total obligation guaranteed by us was $258.7 million, and we had provided four standby letters of credit totaling $18.0 million in connection with four term securitization transactions completed by Ciena.

Ciena relies on the asset-backed securitization market to finance its loan origination activity. That financing source continues to be unreliable in the current capital markets, and as a result, Ciena has substantially curtailed loan origination activity, including loan originations under the SBA s 7(a) Guaranteed Loan Program. Ciena continues to reposition its business. However, there is an inherent risk in this repositioning and we continue to work with Ciena on restructuring. Ciena maintains two non-recourse securitization warehouse facilities, and there is no assurance that Ciena will be able to refinance these facilities in the loan securitization market. We have issued performance guaranties whereby we have agreed to indemnify the warehouse providers for any damages, losses, liabilities and related costs and expenses that they may incur as a result of Ciena s failure to perform any of its obligations as loan originator, loan seller or loan servicer under the warehouse securitizations.

The Office of the Inspector General of the SBA (OIG) and the United States Secret Service are conducting ongoing investigations of allegedly fraudulently obtained SBA guaranteed loans issued by Ciena. Specifically, on or about January 9, 2007, Ciena became aware of an indictment captioned as the United States v. Harrington, No. 2:06-CR-20662 pending in the United States District Court for the Eastern District of Michigan. The indictment alleged that a former Ciena employee in the Detroit office engaged in the fraudulent origination of loans guaranteed, in substantial part, by the SBA. We understand that Ciena is working cooperatively with the U.S. Attorney s Office and the investigating agencies with respect to this matter. On October 1, 2007, the former Ciena employee pled guilty to one count of conspiracy to fraudulently originate SBA-guaranteed loans and one count of making a false statement before a grand jury.

On March 6, 2007, Ciena entered into an agreement with the SBA. According to the agreement, Ciena remains a preferred lender in the SBA 7(a) Guaranteed Loan Program and retains the ability to sell loans into the secondary market. As part of this agreement, Ciena agreed to the immediate payment of approximately $10 million to the SBA to cover amounts paid by the SBA with respect to some of the SBA-guaranteed loans that have been the subject of the charges by the U.S. Attorney s Office for the Eastern District of Michigan against Mr. Harrington. Ciena also entered into an escrow agreement with the SBA and an escrow agent in which Ciena agreed to deposit $10 million with the escrow agent for any additional payments Ciena may be obligated to pay to the SBA in the future under the agreement. During the term of the agreement, any loans originated by Ciena that will be sold into the secondary market or loans that default after having been sold into the secondary market will be reviewed by an independent third party selected by the SBA prior to the sale of such loans into the secondary market or prior to reimbursement by the SBA. Ciena remains subject to SBA rules and regulations and as a result may be required to make additional payments to the SBA in the ordinary course of business.

As an SBA lender, Ciena is also subject to other SBA and OIG audits, investigations, and reviews. In addition, the Office of the Inspector General of the U.S. Department of Agriculture is conducting an investigation of Ciena s lending practices under the Business and Industry Loan (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. These investigations, audits and reviews are ongoing.

On or about January 16, 2007, Ciena and its subsidiary Business Loan Center LLC (BLC) became aware of a lawsuit titled, United States, ex rel James R. Brickman and Greenlight Capital, Inc. v. Business Loan Express LLC f/k/a Business Loan Express, Inc.; Business Loan Center LLC f/k/a Business Loan Center, Inc.; Robert Tannenhauser; Matthew McGee; and George Harrigan, 05-CV-3147 (JEC). The complaint includes allegations arising under the False Claims Act and relating to alleged fraud in connection with SBA guarantees on shrimp vessel loans. On December 18, 2007, the United States District Court for the Northern District of Georgia dismissed all claims in this matter. The plaintiffs are appealing the dismissal.

These investigations, audits, reviews, and litigation have had and may continue to have a material adverse impact on Ciena and, as a result, could continue to negatively affect our financial results. We have considered Ciena s current regulatory issues, ongoing investigations, litigation, and the repositioning of its business in performing the valuation of Ciena at March 31, 2008, and December 31, 2007. See Results of Operations Valuation of Ciena Capital LLC below. We are monitoring the situation.

Mercury Air Centers, Inc. At March 31, 2007, our investment in Mercury Air Centers, Inc. (Mercury) totaled $84.8 million at cost and $301.4 million at value, which included unrealized appreciation of $216.6 million. At December 31, 2006, our investment in Mercury totaled $84.3 million at cost and $244.2 million at value, or 5.0% of our total assets, which included unrealized appreciation of $159.9 million. We completed the purchase of a majority ownership in Mercury in April 2004.

In August 2007, we completed the sale of our majority equity interest in Mercury. For the year ended December 31, 2007, we realized a gain of $262.4 million, subject to post-closing adjustments. In addition, we were repaid approximately $51 million of subordinated debt outstanding to Mercury at closing.

Mercury owned and operated fixed base operations generally under long-term leases from local airport authorities, which consisted of terminal and hangar complexes that serviced the needs of the general aviation community. Mercury was headquartered in Richmond Heights, OH.

Total interest and related portfolio income earned from our investment in Mercury for the three months ended March 31, 2007 and for the years ended December 31, 2007, 2006, and 2005, was as follows:

	Three Months Ended March 31,	Year Ended December 31		
	2007	2007	2006	2005
($ in millions)				
Interest income	$ 2.0	$ 5.1	$ 9.3	$ 8.8
Fees and other income	0.1	0.2	0.6	0.7
Total interest and related portfolio income	$ 2.1	$ 5.3	$ 9.9	$ 9.5

Net change in unrealized appreciation or depreciation for the three months ended March 31, 2007, included an increase in unrealized appreciation totaling $56.7 million related to our investment in Mercury. Net change in unrealized appreciation or depreciation for the year ended December 31, 2007, included an increase in unrealized appreciation totaling $74.9 million for the first half of 2007 and the reversal of

$234.8 million associated with the sale of our majority equity interest in the third quarter of 2007. Net change in unrealized appreciation or depreciation included a net increase in unrealized appreciation on our investment in Mercury of $106.1 million and $53.8 million for the years ended December 31, 2006 and 2005, respectively.

Advantage Sales & Marketing, Inc. At December 31, 2005, our investment in Advantage totaled $257.7 million at cost and $660.4 million at value, or 16.4% of our total assets, which included unrealized appreciation of $402.7 million. Advantage is a sales and marketing agency providing outsourced sales, merchandising, and marketing services to the consumer packaged goods industry. Advantage has offices across the United States and is headquartered in Irvine, CA. We completed the purchase of a majority ownership in Advantage in June 2004.

On March 29, 2006, we sold our majority equity interest in Advantage. We were repaid our $184 million in subordinated debt outstanding at closing. For the year ended December 31, 2006, we realized a gain on the sale of our equity investment of $434.4 million, subject to post-closing adjustments and excluding any earn-out amounts. We realized additional gains in 2008 and 2007, resulting from post-closing adjustments and an earn-out payment totaling $1.7 million and $3.4 million, respectively, subject to additional post-closing adjustments.

As consideration for the common stock sold in the transaction, we received a $150 million subordinated note, with the balance of the consideration paid in cash. In addition, a portion of our cash proceeds from the sale of the common stock were placed in escrow, subject to certain holdback provisions. At March 31, 2008, and December 31, 2007, the amount of the escrow included in other assets on our consolidated balance sheet was approximately $23 million and $25 million, respectively. For tax purposes, the receipt of the $150 million subordinated note as part of our consideration for the common stock sold and the hold back of certain proceeds in escrow will generally allow us, through installment treatment, to defer the recognition of taxable income for a portion of our realized gain until the note or other amounts are collected.

Total interest and related portfolio income earned from our investment in Advantage while we held a majority equity interest was $14.1 million (which included a prepayment premium of $5.0 million), and $37.4 million, for the years ended December 31, 2006, and 2005, respectively. In addition, we earned structuring fees of $2.3 million on our new $150 million subordinated debt investment in Advantage upon the closing of the sale transaction in 2006. Net change in unrealized appreciation or depreciation for the year ended December 31, 2006, included the reversal of $389.7 million of previously recorded unrealized appreciation associated with the realization of a gain on the sale of our majority equity interest in Advantage and for the year ended December 31, 2005, included an increase in unrealized appreciation of $378.4 million, related to our majority equity interest investment in Advantage.

In connection with the sale transaction, we retained an equity investment in the business valued at $15 million at closing as a minority shareholder. During the fourth quarter of 2006, Advantage made a distribution on this minority equity investment, which resulted in a realized gain of $4.8 million.

Our investment in Advantage, which was composed of subordinated debt and a minority equity interest, totaled $155.7 million at cost and $167.6 million at value, which included unrealized appreciation of $11.9 million at March 31, 2008, and $154.8 million at cost and $165.8 million at value, which included unrealized appreciation of $11.0 million at December 31, 2007.

Commercial Real Estate Finance

The commercial real estate finance portfolio at value, investment activity, and the yield on interest-bearing investments at and for the three months ended March 31, 2008 and 2007, and at and for the years ended December 31, 2007, 2006, and 2005, were as follows:

	At and for the Three Months Ended March 31,				At and for the Years Ended December 31,					
	2008		2007		2007		2006		2005	
($ in millions)	Value	Yield[1]	Value	Yield[1]	Value	Yield[1]	Value	Yield[1]	Value	Yield[1]
Portfolio at value:										
Commercial mortgage loans	$ 53.5	7.9%	$ 72.2	7.5%	65.4	6.8%	71.9	7.5%	102.6	7.6%
Real estate owned	30.2		21.0		21.3		19.6		13.9	
Equity interests	32.1		29.3		34.5		26.7		10.6	
Total portfolio	$ 115.8		$ 122.5		$ 121.2		$ 118.2		$ 127.1	
Investments funded	$ 0.5		$		$ 18.0		$ 14.4		$ 213.5	
Payment-in-kind interest, net of cash collections	$ 0.2		$ 0.2		$ (0.7)		$ 0.8		$ 0.0	
Principal collections related to investment repayments or sales [2]	$ 8.4		$ 0.4		$ 23.4		$ 39.9		$ 799.5	

[1] The weighted average yield on the interest-bearing investments is computed as the (a) annual stated interest on accruing loans plus the annual amortization of loan origination fees, original issue discount, and market discount on accruing interest-bearing investments less the annual amortization of origination costs, divided by (b) total interest-bearing investments at value. The weighted average yield is computed as of the balance sheet date. Interest-bearing investments for the commercial real estate finance portfolio include all investments except for real estate owned and equity interests.

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

Our commercial real estate investments funded for the three months ended March 31, 2008 and for the years ended December 31, 2007, 2006, and 2005, were as follows:

	Face	Amount

($ in millions)	Amount	Discount	Funded
For the Three Months Ended March 31, 2008			
Commercial mortgage loans	$ 0.5	$	$ 0.5
Equity interests			
Total	$ 0.5		$ 0.5
For the Year Ended December 31, 2007			
Commercial mortgage loans	$ 17.0	$	$ 17.0
Equity interests	1.0		1.0
Total	$ 18.0	$	$ 18.0
For the Year Ended December 31, 2006			
Commercial mortgage loans	$ 8.0		$ 8.0
Equity interests	6.4		6.4
Total	$ 14.4	$	$ 14.4
For the Year Ended December 31, 2005			
CMBS bonds[1]	$ 211.5	$ (90.5)	$ 121.0
Commercial mortgage loans	88.5	(0.8)	87.7
Equity interests	4.8		4.8
Total	$ 304.8	$ (91.3)	$ 213.5

[1] The CMBS bonds invested in during 2005 were sold on May 3, 2005.

At March 31, 2008, we had outstanding funding commitments related to the commercial real estate portfolio of $40.0 million, and commitments in the form of standby letters of credit and guarantees related to equity interests of $8.2 million.

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

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

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

Managed Funds

We manage funds that invest in the debt and equity of primarily private middle market companies in a variety of industries (together, the Managed Funds). As of March 31, 2008 and December 31, 2007, the funds that we manage had total assets of approximately $1.2 billion and $400 million, respectively. During 2007, we established the Allied Capital Senior Debt Fund, L.P. and the Unitranche Fund LLC, and in the first quarter of 2008, we formed the AGILE Fund I, LLC, and assumed the management of Kinghtsbridge CLO 2007-1 Ltd., all discussed below. Our responsibilities to the Managed Funds may include deal origination, underwriting, and portfolio monitoring and development services consistent with the activities that we perform for our portfolio. Each of the Managed Funds may separately invest in the debt or equity of a portfolio company. Our portfolio may include debt or equity investments issued by the same portfolio company as investments held by one or more Managed Funds, and these investments may be senior, pari passu or junior to the debt and equity investments held by us. We may or may not participate in investments made by investment funds managed by us or one of our affiliates. We expect to continue to grow our managed capital base and have identified other private equity-related funds that we intend to develop. By growing our privately managed capital base, we are seeking to diversify our sources of capital, leverage our core investment expertise and increase fees and other income from asset management activities. See Risk Factors There are potential conflicts of interest between us and the funds managed by us.

Allied Capital Senior Debt Fund, L.P. The Allied Capital Senior Debt Fund, L.P. (ACSDF) is a private fund that generally invests in senior, unitranche and second lien debt. ACSDF has closed on $125 million in equity capital commitments and had total assets of approximately $432 million and $400 million at March 31, 2008 and December 31, 2007, respectively. AC Corp, our wholly-owned subsidiary, is the investment manager and Callidus acts as special manager to ACSDF. One of our affiliates is the general partner of ACSDF, and AC Corp serves as collateral manager to a warehouse financing vehicle associated with ACSDF. AC Corp will earn a management fee of up to 2% per annum of the net asset value of ACSDF and will pay Callidus 25% of that management fee to compensate Callidus for its role as special manager.

We are a special limited partner in ACSDF, which is a portfolio investment, and have committed and funded $31.8 million to ACSDF. At March 31, 2008, our investment in ACSDF totaled $31.8 million at cost and $32.6 million at value, and at December 31, 2007 totaled $31.8 million at cost and $32.8 million at value. As a special limited partner, we expect to earn an incentive allocation of 20% of ACSDF s annual net income earned in excess of a specified minimum return, subject to certain performance benchmarks. The value of our investment in ACSDF is based on the net asset value of ACSDF, which reflects the capital invested plus our allocation of the net earnings of ACSDF, including the incentive allocation.

We may offer to sell loans to ACSDF or the warehouse financing vehicle. ACSDF or the warehouse financing vehicle may purchase loans from us. In connection with ACSDF s formation in June 2007 and during the second half of 2007, we sold $224.2 million of seasoned assets with a weighted average yield of 10.0% to a warehouse financing vehicle associated with ACSDF. In the first quarter of 2008, we sold $30.0 million of seasoned assets with a weighted average yield of 8.2% to the warehouse financing vehicle. ACSDF also purchases loans from other third parties. In addition, during the second half of 2007, we repurchased one asset for $12.0 million from ACSDF, which we had sold to ACSDF in June 2007.

Unitranche Fund LLC. In December 2007, we formed the Unitranche Fund LLC (Unitranche Fund), which we co-manage with an affiliate of General Electric Capital Corporation (GE). The Unitranche Fund is a private fund that generally focuses on making first lien unitranche loans to middle market companies with EBITDA of at least $15 million. The Unitranche Fund may invest up to $270 million in a single borrower. For financing needs greater than $270 million, we and GE may jointly underwrite additional financing for a total unitranche financing of up to $500 million. Allied Capital, GE and the Unitranche Fund may co-invest in a single borrower, with the Unitranche Fund holding at least a majority of the issuance. GE has committed $3.075 billion to the Unitranche Fund consisting of $3.0 billion of senior notes and $0.075 billion of subordinated certificates and we have committed $525.0 million of subordinated certificates. The Unitranche Fund will be capitalized as transactions are completed. At March 31, 2008 the Unitranche Fund had total assets of approximately $142 million. At March 31, 2008 and December 31, 2007, our investment in the Unitranche Fund totaled $31.5 million at cost and at value and $0.7 million at cost and at value, respectively.

The Unitranche Fund is governed by an investment committee with equal representation from Allied Capital and GE and both Allied Capital and GE provide origination, underwriting and portfolio management services to the Unitranche Fund and its affiliates. We will earn a management and sourcing fee totaling 0.375% per annum of managed assets.

AGILE Fund I, LLC. In January 2008, we entered into an investment agreement with the Goldman Sachs Private Equity Group, part of Goldman Sachs Asset Management (Goldman Sachs). As part of the investment agreement, we agreed to sell a pro-rata strip of private equity and debt investments to AGILE Fund I, LLC (AGILE), a private fund in which a fund managed by Goldman Sachs owns substantially all of the interests, for a total transaction value of $167 million. The sales of the assets closed in the first quarter of 2008.

The sale to AGILE included 13.7% of our equity investments in 23 of our buyout portfolio companies and 36 of our minority equity portfolio companies for a total purchase price of $104 million, which resulted in a net realized gain of $8.8 million and dividend income of $5.4 million. In addition, we sold approximately $63 million in debt investments, which represented 7.3% of our unitranche, second lien and subordinated debt investments in the buyout investments included in the equity sale. AGILE generally has the right to co-invest in its proportional share of any future follow-on investment opportunities presented by the companies in its portfolio.

We are the managing member of AGILE, and are entitled to an incentive allocation subject to certain performance benchmarks. We own the remaining interests in AGILE not held by Goldman Sachs. At March 31, 2008, AGILE had total assets of approximately $174 million and our investment in AGILE totaled $0.9 million at cost and at value.

In addition, pursuant to the investment agreement Goldman Sachs has committed to invest at least $125 million in future investment vehicles managed by us and will have future opportunities to invest in our affiliates, or vehicles managed by them, and to coinvest alongside us in the future, subject to various terms and conditions.

As part of this transaction, we sold nine venture capital and private equity limited partnership investments for approximately $28 million to a fund managed by Goldman Sachs, which assumed the $4.7 million of unfunded commitments related to these limited partnership investments. The sales of these limited partnership investments closed at the end of the first quarter of 2008 and resulted in a net realized loss of $5.5 million.

Knightsbridge CLO 2007-1 Ltd. On March 31, 2008, we assumed the management of Knightsbridge CLO 2007-1 Ltd. We earn a management fee of up to 0.6% per annum of the assets of the fund. Callidus may assist us in the management of the fund and we may pay Callidus a portion of the management fee earned for this assistance. This CLO invests primarily in middle market senior loans. At March 31, 2008 Knightsbridge CLO 2007-1 Ltd. had total assets of approximately $500 million and our investment in this CLO totaled $54.4 million at cost and $53.0 million at value.

In aggregate, including the total assets on our balance sheet and capital committed to our Managed Funds, we have more than $9 billion in managed capital.

PORTFOLIO ASSET QUALITY

Portfolio by Grade. We employ a grading system for our entire portfolio. Grade 1 is used for those investments from which a capital gain is expected. Grade 2 is used for investments performing in accordance with plan. Grade 3 is used for investments that require closer monitoring; however, no loss of investment return or principal is expected. Grade 4 is used for investments that are in workout and for which some loss of current investment return is expected, but no loss of principal is expected. Grade 5 is used for investments that are in workout and for which some loss of principal is expected.

At March 31, 2008, and December 31, 2007 and 2006, our portfolio was graded as follows:

	2008		2007		2006	
Grade	Portfolio at Value	Percentage of Total Portfolio	Portfolio at Value	Percentage of Total Portfolio	Portfolio at Value	Percentage of Total Portfolio
($ in millions)						
1	$ 1,301.7	28.1%	$ 1,539.6	32.2%	$ 1,307.3	29.1%
2	3,079.8	66.4	2,915.7	61.0	2,672.3	59.4
3	141.1	3.1	122.5	2.6	308.1	6.9
4	61.6	1.3	157.2	3.3	84.2	1.9
5	51.4	1.1	45.5	0.9	124.2	2.7
	$ 4,635.6	100.0%	$ 4,780.5	100.0%	$ 4,496.1	100.0%

The amount of the portfolio in each grading category may vary substantially from period to period resulting primarily from changes in the composition of the portfolio as a result of new investment, repayment, and exit activity, changes in the grade of investments to reflect our expectation of performance, and changes in investment values. We expect that a number of investments will be in the Grades 4 or 5 categories from time to time. Part of the private equity business is working with troubled portfolio companies to improve their businesses and protect our investment. The number and amount of investments included in Grade 4 and 5 may fluctuate from period to period. We continue to follow our historical practice of working with portfolio companies in order to recover the maximum amount of our investment.

Total Grade 4 and 5 portfolio assets were $113.0 million, $202.7 million and $208.4 million, respectively, or were 2.4%, 4.2% and 4.6%, respectively, of the total portfolio value at March 31, 2008, December 31, 2007 and 2006. Grade 4 and 5 assets include loans, debt securities, and equity securities.

At March 31, 2008, and December 31, 2007, our Class A equity interests in Ciena, valued at $29.3 million and $68.6 million, respectively, were classified as Grade 5 and Grade 4, respectively, and our Class B and Class C equity interests, which had no value, were classified as Grade 5 at both periods. At December 31, 2006, $135.9 million of our investment in Ciena at value was classified as Grade 3, which included our Class A equity interests and certain of our Class B equity interests that were not depreciated, and $74.8 million of our investment in Ciena at value was classified as Grade 5, which included certain of our Class B equity interests and all our Class C equity interests that were depreciated at December 31, 2006. See Private Finance Ciena Capital LLC above.

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

At March 31, 2008, and December 31, 2007 and 2006, loans and debt securities at value not accruing interest for the total investment portfolio were as follows:

($ in millions)	**2008**	**2007**	**2006**
Loans and debt securities in workout status (classified as Grade 4 or 5)[1]			
Private finance			
Companies more than 25% owned	$ 62.4	$ 114.1	$ 51.1
Companies 5% to 25% owned	2.6	11.7	4.0
Companies less than 5% owned	23.3	23.8	31.6
Commercial real estate finance	5.9	12.4	12.2
Loans and debt securities not in workout status			
Private finance			
Companies more than 25% owned	31.0	21.4	87.1
Companies 5% to 25% owned	12.3	13.4	7.2
Companies less than 5% owned	11.7	13.3	38.9
Commercial real estate finance	1.5	1.9	6.7
Total	$ 150.7	$ 212.0	$ 238.8
Percentage of total portfolio	3.3%	4.4%	5.3%

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

At March 31, 2008, and December 31, 2007 and 2006, our Class A equity interests in Ciena of $29.3 million, which represented 0.6% of the total portfolio at value, $68.6 million, which represented 1.4% of the total portfolio at value, and $66.6 million, which represented 1.5% of the total portfolio at value, respectively, were included in non-accruals. At March 31, 2008, these Class A equity interests were classified as Grade 5, at December 31, 2007, these Class A equity interests were classified as Grade 4 and at December 31, 2006, these Class A equity interests were classified as Grade 3. See Private Finance Ciena Capital LLC above.

Loans and Debt Securities Over 90 Days Delinquent. Loans and debt securities greater than 90 days delinquent at value at March 31, 2008, December 31, 2007 and 2006, were as follows:

	2008	2007	2006
($ in millions)			
Private finance	$ 54.0	$ 139.9	$ 46.5
Commercial mortgage loans	15.4	9.2	1.9
Total	$ 69.4	$ 149.1	$ 48.4
Percentage of total portfolio	1.5%	3.1%	1.1%

Loans and debt securities over 90 days delinquent at March 31,2008 and December 31, 2007, include our investment in the Class A equity interests of Ciena, which became over 90 days delinquent in the first quarter of 2007. The amount of loans and debt securities over 90 days delinquent increased from $48.4 million at December 31, 2006, to $149.1 million at December 31, 2007, primarily due to not receiving payment on our Class A equity interests of Ciena. At March 31, 2008, and December 31, 2007, the Class A equity interests were $29.3 million or 0.6% of the total portfolio at value and $68.6 million, or 1.4% of the total portfolio at value, respectively. These equity interests were placed on non-accrual during the fourth quarter of 2006. See Private Finance, Ciena Capital LLC above.

The amount of the portfolio that is on non-accrual status or greater than 90 days delinquent may vary from period to period. Loans and debt securities on non-accrual status and over 90 days delinquent should not be added together as they are two separate measures of portfolio asset quality. Loans and debt securities that are in both categories (i.e., on non-accrual status and over 90 days delinquent) totaled $55.5 million, $149.1 million and $44.3 million at March 31, 2008, December 31, 2007 and 2006, respectively.

OTHER ASSETS AND OTHER LIABILITIES

Other assets is primarily composed of fixed assets, prepaid expenses, deferred financing and offering costs, and accounts receivable, which includes amounts received in connection with the sale of portfolio companies, including amounts held in escrow, and other receivables from portfolio companies. At March 31, 2008, and December 31, 2007 and 2006, other assets totaled $171.3 million, $157.9 million and $123.0 million, respectively. The increase in other assets since year end 2007 was primarily the result of an increase in accounts receivable due to $32.4 million in consideration received in connection with the sale of investments, which was received in cash in April 2008, partially offset by the March 2008 distribution of the assets held in deferred compensation trusts, which totaled $21.1 million at December 31, 2007.

Accounts payable and other liabilities is primarily composed of the liabilities related to accrued interest, bonus and taxes, including excise tax. At March 31, 2008, and December 31, 2007 and 2006, accounts payable and other liabilities totaled $62.3 million, $153.3 million and $147.1 million, respectively. The decrease in accounts payable and other liabilities since year end 2007 was primarily the result of the termination of the deferred compensation plans in March 2008, the liability for which totaled $52.5 million at December 31, 2007. In addition, accounts payable and other liabilities were reduced by the payment of liabilities at December 31, 2007, related to accrued 2007 bonuses of $40.1 million and excise tax of $16.0 million, offset by increases in the first quarter of 2008 related to accrued bonuses and excise tax totaling $12.6 million and interest payable totaling $11.5 million. Accrued interest payable fluctuates from period to period depending on the amount of debt outstanding and the contractual payment dates of the interest on such debt.

RESULTS OF OPERATIONS

Comparison of the Three Months Ended March 31, 2008 and 2007

The following table summarizes our operating results for the three months ended March 31, 2008 and 2007.

(In thousands, except per share amounts)	For the Three Months Ended March 31, 2008	2007	Change	Percent Change
	(unaudited)			
Interest and Related Portfolio Income				
Interest and dividends	$ 134,660	$ 101,983	$ 32,677	32%
Fees and other income	10,284	5,969	4,315	72%
Total interest and related portfolio income	144,944	107,952	36,992	34%
Expenses				
Interest	37,560	30,288	7,272	24%
Employee	22,652	21,928	724	3%
Employee stock options	4,195	3,661	534	15%
Administrative	9,019	13,224	(4,205)	(32)%
Total operating expenses	73,426	69,101	4,325	6%
Net investment income before income taxes	71,518	38,851	32,667	84%
Income tax expense (benefit), including excise tax	1,969	(649)	2,618	403%
Net investment income	69,549	39,500	30,049	76%
Net Realized and Unrealized Gains (Losses)				
Net realized gains	3,143	27,666	(24,523)	*
Net change in unrealized appreciation or depreciation	(113,404)	65,920	(179,324)	*
Total net gains (losses)	(110,261)	93,586	(203,847)	*
Net income	$ (40,712)	$ 133,086	$ (173,798)	(131)%
Diluted earnings per common share	$ (0.25)	$ 0.87	$ (1.12)	(129)%
Weighted average common shares outstanding diluted	161,507	152,827	8,686	6%

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

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

Interest and Dividends. Interest and dividend income for the three months ended March 31, 2008 and 2007, was composed of the following:

($ in millions)	2008	2007
Interest		
Private finance loans and debt securities	$ 107.0	$ 92.9
Preferred shares/income notes of CLOs	7.5	3.7
Subordinated certificates in Unitranche Fund LLC	0.3	
Commercial mortgage loans	1.2	1.3
Cash, U.S. Treasury bills, money market and other securities	1.8	2.8
Total interest	117.8	100.7
Dividends	16.9	1.3
Total interest and dividends	$ 134.7	$ 102.0

The level of interest income, which includes interest paid in cash and in kind, is directly related to the balance of the interest-bearing investment portfolio outstanding during the period multiplied by the weighted average yield. The interest-bearing investments in the portfolio at value and the yield on the interest-bearing investments in the portfolio at March 31, 2008 and 2007, were as follows:

	2008		2007	
($ in millions)	Value	Yield(1)	Value	Yield(1)
Loans and debt securities:				
Private finance	$ 3,411.8	12.2%	$ 3,091.3	11.7%
Commercial mortgage loans	53.5	7.9%	72.2	7.5%
Total loans and debt securities	3,465.3	12.1%	$ 3,163.5	11.6%
Equity securities:				
Preferred shares/income notes of CLOs	197.4	15.8%	96.1	13.5%
Subordinated certificates in Unitranche Fund LLC	31.5	12.4%		
Total	$ 3,694.2	12.3%	$ 3,259.6	11.7%

(1) The weighted average yield on loans and debt securities is computed as the (a) annual stated interest on accruing loans and debt securities plus the annual amortization of loan origination fees, original issue discount, and market discount on accruing loans and debt securities less the annual amortization of loan origination costs, divided by (b) total interest-bearing investments at value. The weighted average yield on the preferred shares/income notes of CLOs is calculated as the (a) effective interest yield on the preferred shares/income notes of CLOs, divided by (b) preferred shares/income notes of CLOs at value. The weighted average yield on the subordinated certificates in the Unitranche Fund LLC is computed as the (a) annual stated interest (LIBOR

plus 7.5%) divided by (b) total investment at value. The weighted average yields are computed as of the balance sheet date.

Our interest income from our private finance loans and debt securities has increased period over period primarily as a result of the growth in this portfolio. The private finance loan and debt securities portfolio yield at March 31, 2008, of 12.2% as compared to the private finance portfolio yield of 11.7% at March 31, 2007, reflects the mix of debt investments in the private finance loan and debt securities portfolio. The weighted average yield varies from period to period based on the current stated interest on loans and debt securities and the amount of loans and debt securities for which interest is not accruing. See the discussion of the private finance portfolio yield above under the caption Portfolio and Investment Activity Private Finance.

Interest income also includes the effective interest yield on our investments in the preferred shares/income notes of CLOs. Interest income from these investments has increased period over period primarily as a result of the growth in these assets. The weighted average yield on the preferred shares/income notes of the CLOs at March 31, 2008, was 15.8%, as compared to the weighted average yield on the preferred shares/income notes of the CLOs of 13.5% at March 31, 2007.

The value and weighted average yield of the cash, U.S. Treasury bills, money market and other securities was $201.6 million and 1.5%, respectively, at March 31, 2008, and $271.5 million and 5.3%, respectively, at March 31, 2007. See Financial Condition, Liquidity and Capital Resources below.

Dividend income results from the dividend yield on preferred equity interests, if any, or the declaration of dividends by a portfolio company on preferred or common equity interests. Dividend income for the three months ended March 31, 2008, was $16.9 million as compared to $1.3 million for the three months ended March 31, 2007. The increase period over period was primarily a result of a $7.1 million dividend received in connection with the recapitalization of Norwesco, Inc., a portfolio company, and $5.5 million of dividends paid in cash in connection with the sale to AGILE Fund I, LLC during the first quarter of 2008. See Portfolio and Investment Activity Managed Funds above. Dividend income will vary from period to period depending upon the timing and amount of dividends that are declared or paid by a portfolio company on preferred or common equity interests.

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

Fees and other income for the three months ended March 31, 2008 and 2007, included fees relating to the following:

($ in millions)	2008	2007
Structuring and diligence	$ 5.1	$ 1.8
Management, consulting and other services provided to portfolio companies	2.9	1.8
Commitment, guaranty and other fees from portfolio companies[1]	1.7	2.0
Fund management fees[2]	0.6	
Loan prepayment premiums		0.3
Other income		0.1
Total fees and other income	$ 10.3	$ 6.0

(1) Includes guaranty and other fees from Ciena of $1.4 million for 2007. See Private Finance, Ciena Capital, LLC above.

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

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

Structuring and diligence fees primarily relate to the level of new investment originations. Private finance investments funded were $274.6 million for the three months ended March 31, 2008, as compared to $170.2 million for the three months ended March 31, 2007. Structuring and diligence fees for the three months ended March 31, 2008, included $1.8 million earned by us in connection with investments made by the Unitranche Fund, LLC.

While the scheduled maturities of private finance and commercial real estate loans generally range from five to ten years, it is not unusual for our borrowers to refinance or pay off their debts to us ahead of schedule. Therefore, we generally structure our loans to require a prepayment premium for the first three

to five years of the loan. Accordingly, the amount of prepayment premiums will vary depending on the level of repayments and the age of the loans at the time of repayment.

See Portfolio and Investment Activity above for further information regarding our total interest related portfolio income for Ciena and Mercury.

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

Interest Expense. The fluctuations in interest expense during the three months ended March 31, 2008 and 2007, were primarily attributable to changes in the level of our borrowings under various notes payable and our revolving line of credit. Our borrowing activity and weighted average cost of debt, including fees and debt financing costs, at and for the three months ended March 31, 2008 and 2007, were as follows:

($ in millions)	**2008**	**2007**
Total outstanding debt	$ 2,191.6	$ 1,891.5
Average outstanding debt	$ 2,209.5	$ 1,841.2
Weighted average cost[1]	6.2%	6.5%

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

In addition, interest expense included interest paid to the Internal Revenue Service related to installment sale gains totaling $1.9 million and $0.3 million for the three months ended March 31, 2008 and 2007, respectively. Installment interest expense for the year ended December 31, 2008, is estimated to be a total of $7.7 million. See Dividends and Distributions below.

Employee Expense. Employee expenses for the three months ended March 31, 2008 and 2007, were as follows:

($ in millions)	**2008**	**2007**
Salaries and employee benefits	$ 22.7	$ 21.4
Individual performance award (IPA)	2.4	2.5
IPA mark to market expense (benefit)	(4.1)	(4.0)
Individual performance bonus (IPB)	1.7	2.0
Total employee expense[1]	$ 22.7	$ 21.9
Number of employees at end of period	186	170

[1] Excludes stock options expense. See below.

The change in salaries and employee benefits reflects the effect of an increase in the number of employees, compensation increases, and the change in mix of employees given their area of responsibility and relevant experience level. Salaries and employee benefits include an accrual for employee bonuses, which are generally paid annually after the completion of the fiscal year. The quarterly accrual is based upon an estimate of annual bonuses and is subject to change. The amount of the current year bonuses will be finalized by the Compensation Committee and the Board of Directors at the end of the year. Salaries and employee benefits included accrued bonuses of $10.3 million and $10.4 million for the three months ended March 31, 2008 and 2007, respectively.

The IPA is an incentive compensation program for certain officers and is generally determined annually at the beginning of each year but may be adjusted throughout the year. Through December 31, 2007, the IPA was deposited in a deferred compensation trust in four equal installments, generally on a quarterly basis, in the form of cash. The trustee was required to use the cash to purchase shares of our common stock in the open market.

Through December 31, 2007, the IPA amounts were contributed into the trust and invested in our common stock. The accounts of the trust were consolidated with our accounts. The common stock was classified as common stock held in deferred compensation trust in the accompanying financial statements and the deferred compensation obligation, which represented the amount owed to the employees, was included in other liabilities. Changes in the value of our common stock held in the deferred compensation trust were not recognized. However, the liability was marked to market with a corresponding charge or credit to employee compensation expense. On March 18, 2008, prior to the distribution of the assets held in the trust, we were required to record a final mark to market of the liability with a corresponding credit to employee compensation expense.

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

The accounts under the deferred compensation arrangements totaled $52.5 million at December 31, 2007. The balances on the termination date were distributed to participants in March 2008 subsequent to the termination date, in accordance with the transition rule for payment elections under Section 409A of the Code. Distributions from the plans were made in cash or shares of our common stock, net of required withholding taxes. The distribution of the accounts under the deferred compensation arrangements will result in a tax deduction for 2008, subject to the limitations set by Section 162(m) of the Code for persons subject to such section.

The IPB is distributed in cash to award recipients throughout the year (beginning in February of each respective year) as long as the recipient remains employed by us.

The Compensation Committee and the Board of Directors have determined the IPA and the IPB for 2008 and they are currently estimated to be approximately $9.5 million each; however, the Compensation Committee may adjust the IPA or IPB as needed, or make new awards as new officers are hired. For 2008, the Compensation Committee has determined that the IPAs will be paid in cash in two equal installments during the year, as long as the recipient remains employed by us. If a recipient terminates employment during the year, any further cash contribution for the IPA or remaining cash payments under the IPB would be forfeited.

Stock Options Expense. Effective January 1, 2006, we adopted FASB Statement No. 123 (Revised 2004), *Share-Based Payment* (SFAS 123R) using the modified prospective method of application, which required us to recognize compensation costs on a prospective basis beginning January 1, 2006. 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 proforma 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 in the consolidated statement of operations over the service period. Our employee stock options are typically granted with ratable vesting provisions, and we amortize the compensation cost over the related service period. On February 1, 2008, the Compensation Committee of our Board of Directors granted 7.1 million options with an exercise price of $22.96 per share. The options vest ratably over a three-year period beginning on June 30, 2009.

The stock option expense for the three months ended March 31, 2008 and 2007, was as follows:

($ in millions)	2008	2007
Employee Stock Option Expense:		
Previously awarded, unvested options as of January 1, 2006	$ 1.7	$ 3.2
Options granted on or after January 1, 2006	2.5	0.5
Total employee stock option expense	$ 4.2	$ 3.7

We estimate that the employee-related stock option expense for outstanding unvested options as of March 31, 2008, will be approximately $13.2 million, $6.8 million, and $4.0 million for the years ended December 31, 2008, 2009, and 2010, respectively. This estimate may change if our assumptions related to future option forfeitures change. This estimate does not include any expense related to stock option grants after March 31, 2008, as the fair value of those stock options will be determined at the time of grant.

Administrative Expense. Administrative expenses include legal and accounting fees, valuation assistance fees, insurance premiums, the cost of leases for our headquarters in Washington, DC, and our regional offices, portfolio origination and development expenses, travel costs, stock record expenses, directors fees and stock option expense, and various other expenses.

Administrative expenses for the three months ended March 31, 2008 and 2007, were $9.0 million and $13.2 million, respectively. Administrative expenses declined due to a reduction in investigation and litigation costs, net of insurance reimbursements, of $3.8 million. Administrative expenses for the three months ended March 31, 2007, included costs of $1.4 million incurred to engage a third party to conduct a review of Ciena s internal control systems. See Private Finance, Ciena Capital LLC above.

Income Tax Expense (Benefit), Including Excise Tax. Income tax expense (benefit) for the three months ended March 31, 2008 and 2007, was as follows:

($ in millions)	2008	2007
Income tax expense (benefit)	$ (0.3)	$ (4.2)
Excise tax expense[1]	2.3	3.6
Income tax expense (benefit), including excise tax	$ 2.0	$ (0.6)

[1] While excise tax expense is presented in the Consolidated Statement of Operations as a reduction to net investment income, excise tax relates to both net investment income and net realized gains.

Our wholly-owned subsidiary, A.C. Corporation, is a corporation subject to federal and state income taxes and records a benefit or expense for income taxes as appropriate based on its operating results in a given period.

Our excess taxable income carried over from 2007 plus our estimated annual taxable income for 2008 currently exceeds our estimated dividend distributions to shareholders in 2008, therefore, we expect to carry over excess taxable income earned in 2008 for distribution in 2009. Therefore, we will generally be required to pay an excise tax equal to 4% of the amount by which 98% of our annual taxable income exceeds the distributions for the year. We have recorded an estimated excise tax of $2.3 million for the three months ended March 31, 2008. See Dividends and Distributions.

Realized Gains and Losses. Net realized gains primarily result from the sale of equity securities associated with certain private finance investments and the realization of unamortized discount resulting

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from the sale and early repayment of private finance loans and commercial mortgage loans, offset by losses on investments. Net realized gains for the three months ended March 31, 2008 and 2007, were as follows:

($ in millions)	**2008**	**2007**
Realized gains	$ 32.7	$ 33.2
Realized losses	(29.6)	(5.5)
Net realized gains	$ 3.1	$ 27.7

The realized gains and losses for the three months ended March 31, 2008, were primarily a result of the sale to AGILE Fund I, LLC. The net realized gain from this transaction totaled $8.8 million. In addition, realized losses for the quarter included $5.5 million related to the sale of the venture capital and private equity limited partnership investments to a fund managed by Goldman Sachs. See Managed Funds above.

When we exit an investment and realize a gain or loss or receive a dividend on an equity security from a portfolio company, we make an accounting entry to reverse any unrealized appreciation or depreciation, respectively, we had previously recorded to reflect the appreciated or depreciated value of the investment. For the three months ended March 31, 2008 and 2007, we reversed previously recorded unrealized appreciation or depreciation when gains or losses were realized or when dividends were received as follows:

($ in millions)	**2008**	**2007**
Reversal of previously recorded net unrealized appreciation associated with realized gains	$ (32.5)	$ (32.1)
Reversal of previously recorded net unrealized appreciation associated with dividends received	(13.5)	
Reversal of previously recorded net unrealized depreciation associated with realized losses	28.5	5.8
Total reversal	$ (17.5)	$ (26.3)

Realized gains for the three months ended March 31, 2008 and 2007, were as follows:
($ in millions)

	2008
Portfolio Company	**Amount**
Private Finance:	
Norwesco, Inc.	$ 10.7
BenefitMall, Inc.	4.9
Financial Pacific Company	3.1
Penn Detroit Diesel Allison, LLC	1.7
Service Champ, Inc.	1.7
Advantage Sales & Marketing, Inc.[(1)]	3.2
Coverall North America, Inc.	1.4
CR Holding, Inc.	1.0
Other	4.9

Total private finance		32.6
Commercial Real Estate:		
Other		0.1
Total commercial real estate		0.1
Total realized gains	$	32.7

2007

Portfolio Company		Amount
Private Finance:		
Palm Coast Data, LLC	$	20.0
Mogas Energy, LLC		4.5
Tradesmen International, Inc		3.8
ForeSite Towers, LLC		3.8
Other		1.1
Total realized gains	$	33.2

(1) Includes an additional realized gain of $1.7 million related to the release of escrowed funds from the sale of our majority equity investment in 2006.

Realized losses for the three months ended March 31, 2008 and 2007, were as follows:
($ in millions)

2008

Portfolio Company		**Amount**
Private Finance:		
Crescent Equity Corp. Longview Cable & Data, LLC	$	8.4
Mid-Atlantic Venture Fund IV, L.P.		5.2
WMA Equity Corporation and Affiliates		4.5
Driven Brands, Inc.		1.9
Direct Capital Corporation		1.7
EarthColor, Inc.		1.7
Sweet Traditions, Inc.		1.0
Other		4.9
Total private finance		29.3
Commercial Real Estate:		
Other		0.3
Total commercial real estate		0.3
Total realized losses	$	29.6

2007

Portfolio Company		**Amount**
Private Finance:		
Legacy Partners Group, LLC	$	5.8
Other		(0.3)
Total realized losses	$	5.5

Change in Unrealized Appreciation or Depreciation. We determine the value of each investment in our portfolio on a quarterly basis, and changes in value result in unrealized appreciation or depreciation being recognized in our statement of operations. Value, as defined in Section 2(a)(41) of the Investment Company Act of 1940 (1940 Act), is (i) the market price for those securities for which a market quotation is readily available and (ii) for all other securities and assets, fair value is as determined in good faith by the Board of Directors. Since there is typically no readily available market value for the investments in our portfolio, we value substantially all of our portfolio investments at fair value as determined in good faith by the Board of Directors in accordance with our valuation policy and the provisions of the 1940 Act and FASB Statement No. 157, *Fair Value Measurements* (SFAS 157 or the Statement). We determine fair value to be the price that would be received for an investment in a current sale, which assumes an orderly transaction between market participants on the measurement date. At March 31, 2008, portfolio investments recorded at fair value using level 3 inputs (as defined under the Statement) were approximately 91% of our total assets. Because of the inherent uncertainty of determining the fair value of investments that do not have a readily available market quotation in an active market, the fair value of our investments determined in good faith by the Board of Directors may differ significantly from the values that would have been used had a ready market existed for the investments, and the differences could be material.

There is no single approach for determining fair value in good faith. As a result, determining fair value requires that judgment be applied to the specific facts and circumstances of each portfolio investment while employing a consistently applied valuation process for the types of investments we make. Unlike banks, we are not permitted to provide a general reserve for anticipated loan losses. Instead, we are required to specifically value each individual investment on a quarterly basis. We will record unrealized depreciation on investments when we determine that the fair value of a security is less than its cost basis, and we will record unrealized appreciation when we determine that the fair value is greater than its cost basis. Changes in fair value are recorded in the statement of operations as net change in unrealized appreciation or depreciation.

As a business development company, we invest in illiquid securities including debt and equity securities of portfolio companies, CLO bonds and preferred shares/income notes, CDO bonds and investment funds. The structure of each debt and equity security is specifically negotiated to enable us to protect our investment and maximize our returns. We include many terms governing interest rate, repayment terms, prepayment penalties, financial covenants, operating covenants, ownership parameters, dilution parameters, liquidation preferences, voting rights, and put or call rights. Our investments may be subject to certain restrictions on resale and generally have no established trading market.

Because of the type of investments that we make and the nature of our business, our valuation process requires an analysis of various factors. Our fair value methodology includes the examination of, among other things, the underlying investment performance, financial condition, and market changing events that impact valuation.

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

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

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

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

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

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

The fair value of our CLO/ CDO Assets is generally based on a discounted cash flow model that utilizes prepayment, re-investment and loss assumptions based on historical experience and projected performance, economic factors, the characteristics of the underlying cash flow and comparable yields for similar bonds and preferred shares/income notes, when available. We recognize unrealized appreciation or depreciation on our 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 or loss assumptions in the underlying collateral pool. We determine the fair value of our CLO/ CDO Assets on an individual security-by-security basis. If we were to sell a group of these CLO/ CDO Assets in a pool in one or more transactions, the total value received for that pool may be different than the sum of the fair values of the individual assets.

We will record unrealized depreciation on investments when we determine that the fair value of a security is less than its cost basis, and will record unrealized appreciation when we determine that the fair value is greater than its cost basis. Because of the inherent uncertainty of valuation, the values determined at the measurement date may differ significantly from the values that would have been used had a ready market existed for the investments, and the differences could be material. Additionally, changes in the market environment and other events that may occur over the life of the investments may cause the gains or losses ultimately realized on these investments to be different than the values determined at the measurement date.

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

We work with third-party consultants to obtain assistance in determining fair value for a portion of the private finance portfolio each quarter. We work with these consultants to obtain assistance as additional support in the preparation of our internal valuation analysis. In addition, we may receive third-party assessments of a particular private finance portfolio company s value in the ordinary course of business, most often in the context of a prospective sale transaction or in the context of a bankruptcy process.

The valuation analysis prepared by management is submitted to our Board of Directors who is ultimately responsible for the determination of fair value of the portfolio in good faith. Valuation assistance from Duff & Phelps, LLC (Duff & Phelps) for our private finance portfolio consisted of certain limited procedures (the Procedures) we identified and requested them to perform. Based upon the performance of the Procedures on a selection of our final portfolio company valuations, Duff & Phelps concluded that the fair value of those portfolio companies subjected to the Procedures did not appear unreasonable. In addition, we also received third-party valuation assistance from other third-party consultants for certain private finance portfolio companies. For the three months ended March 31, 2008 and 2007, we received third-party valuation assistance as follows:

	2008	**2007**
Number of private finance portfolio companies reviewed	124	88
Percentage of private finance portfolio reviewed at value	94.0%	91.8%

Professional fees for third-party valuation assistance were $1.8 million for the year ended December 31, 2007, and are estimated to be approximately $2.3 million for 2008.

Net Change in Unrealized Appreciation or Depreciation. Net change in unrealized appreciation or depreciation for the three months ended March 31, 2008 and 2007, consisted of the following:

($ in millions)	**2008[(1)]**	**2007[(1)]**
Net unrealized appreciation (depreciation)	$ (95.9)	$ 92.2
Reversal of previously recorded unrealized appreciation associated with realized gains	(32.5)	(32.1)
Reversal of previously recorded net unrealized appreciation associated with dividends received	(13.5)	
Reversal of previously recorded unrealized depreciation associated with realized losses	28.5	5.8

Net change in unrealized appreciation or depreciation	$	(113.4)	$	65.9

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

The primary drivers of the net unrealized depreciation of $95.9 million resulting from changes in portfolio value for the quarter ended March 31, 2008, were (i) non-buyout debt investments, which depreciated by $9.3 million as a result of using a yield analysis in connection with the adoption of SFAS 157, (ii) additional depreciation of $39.3 million on our investment in Ciena resulting from the decline in value of their residual interest assets and other financial assets as discussed below, and (iii) depreciation in our other financial services and asset management portfolio companies, and our CLO/ CDO investments, which totaled $39.4 million.

Valuation of Ciena Capital LLC. Our investment in Ciena totaled $327.8 million at cost and $29.3 million at value, which included unrealized depreciation of $298.5 million, at March 31, 2008, and $327.8 million at cost and $68.6 million at value, which included unrealized depreciation of $259.2 million, at December 31, 2007.

Ciena relies on the asset-backed securitization market to finance its loan origination activity. That financing source continues to be unreliable in the current capital markets, and as a result, Ciena has substantially curtailed loan origination activity. To value our investment at March 31, 2008, we continued to attribute no value to Ciena s origination platform or enterprise due to the state of the securitization markets, among other factors. The decline in value at March 31, 2008, of $39.3 million reflects the decline in value of Ciena s financial assets, including residual interests, which reduced its book value. We valued our investment in Ciena at March 31, 2008, solely based on the estimated realizable value of Ciena s net assets, including the estimated realizable value of the cash flows generated from Ciena s retained interests in its current servicing portfolio, which includes portfolio servicing fees as well as cash flows from Ciena s equity investments in its securitizations and its interest-only strip. This resulted in a value to our investment, after repayment of senior debt outstanding, of $29.3 million at March 31, 2008.

We also continued to consider Ciena s current regulatory issues and ongoing investigations and litigation in performing the valuation analysis at March 31, 2008. (See Private Finance, Ciena Capital LLC above.)

Net change in unrealized appreciation or depreciation included a net decrease of $39.3 million for the three months ended March 31, 2008, and no change for the three months ended March 31, 2007. We received valuation assistance from Duff & Phelps for our investment in Ciena at March 31, 2008 and 2007. See Valuation Methodology Private Finance above for further discussion of the third-party valuation assistance we received.

Per Share Amounts. All per share amounts included in the Management s Discussion and Analysis of Financial Condition and Results of Operations section have been computed using the weighted average common shares used to compute diluted earnings per share, which were 161.5 million and 152.8 million for the three months ended March 31, 2008 and 2007, respectively.

Comparison of the Years Ended December 31, 2007, 2006, and 2005

The following table summarizes our operating results for the years ended December 31, 2007, 2006, and 2005.

(in thousands, except per share amounts)	2007	2006	Change	Percent Change	2006	2005	Change	Percent Change
Interest and Related Portfolio Income								
Interest and dividends	$ 417,576	$ 386,427	$ 31,149	8%	$ 386,427	$ 317,153	$ 69,274	22%
Fees and other income	44,129	66,131	(22,002)	(33)%	66,131	56,999	9,132	16%
Total interest and related portfolio income	461,705	452,558	9,147	2%	452,558	374,152	78,406	21%
Expenses								
Interest	132,080	100,600	31,480	31%	100,600	77,352	23,248	30%
Employee	89,155	92,902	(3,747)	(4)%	92,902	78,300	14,602	19%
Employee stock options	35,233	15,599	19,634	126%	15,599		15,599	
Administrative	50,580	39,005	11,575	30%	39,005	69,713	(30,708)	(44)%
Total operating expenses	307,048	248,106	58,942	24%	248,106	225,365	22,741	10%
Net investment income before income taxes	154,657	204,452	(49,795)	(24)%	204,452	148,787	55,665	37%
Income tax expense, including excise tax	13,624	15,221	(1,597)	(10)%	15,221	11,561	3,660	32%
Net investment income	141,033	189,231	(48,198)	(25)%	189,231	137,226	52,005	38%
Net Realized and Unrealized Gains (Losses)								
Net realized gains	268,513	533,301	(264,788)	(50)%	533,301	273,496	259,805	95%
Net change in unrealized appreciation or depreciation	(256,243)	(477,409)	221,166	*	(477,409)	462,092	(939,501)	*

Total net gains (losses)	12,270	55,892	(43,622)	*	55,892	735,588	(679,696)	*
Net income	$ 153,303	$ 245,123	$ (91,820)	(37)%	$ 245,123	$ 872,814	$ (627,691)	(72)%
Diluted earnings per common share	$ 0.99	$ 1.68	$ (0.69)	(41)%	$ 1.68	$ 6.36	$ (4.68)	(74)%
Weighted average common shares outstanding diluted	154,687	145,599	9,088	6%	145,599	137,274	8,325	6%

* Net change in unrealized appreciation or depreciation and net gains (losses) can fluctuate significantly from year to year.

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

Interest and Dividends. Interest and dividend income for the years ended December 31, 2007, 2006, and 2005, was composed of the following:

($ in millions)	2007	2006	2005
Interest			
Private finance loans and debt securities	$ 376.1	$ 348.4	$ 247.8
Preferred shares/income notes of CLOs	18.0	11.5	3.2
CMBS and real estate-related CDO portfolio			29.4
Commercial mortgage loans	6.4	8.3	7.6
Cash, U.S. Treasury bills, money market and other securities	15.1	14.0	9.4
Total interest	415.6	382.2	297.4
Dividends	2.0	4.2	19.8
Total interest and dividends	$ 417.6	$ 386.4	$ 317.2

The level of interest income, which includes interest paid in cash and in kind, is directly related to the balance of the interest-bearing investment portfolio outstanding during the year multiplied by the weighted average yield. The interest-bearing investments in the portfolio at value and the yield on the interest-bearing investments in the portfolio at December 31, 2007, 2006, and 2005, were as follows:

	2007		2006		2005	
($ in millions)	Value	Yield(1)	Value	Yield(1)	Value	Yield(1)
Loans and debt securities:						
Private finance	$ 3,414.6	12.1%	$ 3,185.2	11.9%	$ 2,094.9	13.0%
Commercial mortgage loans	65.4	6.8%	71.9	7.5%	102.6	7.6%
Total loans and debt securities	3,480.0	12.0%	3,257.1	11.8%	2,197.5	12.8%
Equity securities:						
Preferred shares/income notes of CLOs	203.0	14.6%	97.2	15.5%	72.3	13.7%
Total interest bearing securities	$ 3,683.0	12.1%	$ 3,354.3	11.9%	$ 2,269.8	12.8%

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

CLOs is calculated as the (a) effective interest yield on the preferred shares/income notes of CLOs, divided by (b) preferred shares/income notes of CLOs at value. The weighted average yields are computed as of the balance sheet date.

Our interest income from our private finance loans and debt securities has increased year over year primarily as a result of the growth in this portfolio. The private finance loan and debt securities portfolio yield at December 31, 2007, of 12.1% as compared to the private finance portfolio yield of 11.9% and 13.0% at December 31, 2006 and 2005, respectively, reflects the mix of debt investments in the private finance loan and debt securities portfolio. The weighted average yield varies from year to year based on the current stated interest on loans and debt securities and the amount of loans and debt securities for which interest is not accruing. See the discussion of the private finance portfolio yield above under the caption Portfolio and Investment Activity Private Finance.

Interest income also includes the effective interest yield on our investments in the preferred shares/income notes of CLOs. Interest income from these investments has increased year over year primarily as a result of the growth in these assets. The weighted average yield on the preferred shares/income notes of the CLOs at December 31, 2007, was 14.6%, as compared to the weighted average yield on the preferred shares/income notes of the CLOs yield of 15.5% and 13.7% at December 31, 2006 and 2005, respectively.

There was no interest income from the CMBS and real estate-related CDO portfolio in 2007 or 2006 as we sold this portfolio on May 3, 2005. The CMBS and CDO portfolio sold had a cost basis of $718.1 million and a weighted average yield on the cost basis of the portfolio of approximately 13.8%. We generally reinvested the principal proceeds from the CMBS and CDO portfolio into our private finance portfolio.

Interest income from cash, U.S. Treasury bills, money market and other securities results primarily from interest earned on our liquidity portfolio and excess cash on hand. During the fourth quarter of 2005, we established a liquidity portfolio that was composed primarily of money market and other securities and U.S. Treasury bills. At December 31, 2007, the liquidity portfolio was composed primarily of money market securities. See Financial Condition, Liquidity and Capital Resources below. The value and weighted average yield of the liquidity portfolio was $201.2 million and 4.6%, respectively, at December 31, 2007, $201.8 million and 5.3%, respectively, at December 31, 2006, and $200.3 million and 4.2%, respectively, at December 31, 2005.

Dividend income results from the dividend yield on preferred equity interests, if any, or the declaration of dividends by a portfolio company on preferred or common equity interests. Dividend income will vary from year to year depending upon the timing and amount of dividends that are declared or paid by a portfolio company on preferred or common equity interests. Dividend income for the years ended December 31, 2007 and 2006, did not include any dividends from Ciena. See Private Finance, Ciena Capital LLC above. Dividend income for the year ended December 31, 2005, included dividends from Ciena on the Class B equity interests held by us of $14.0 million. For the year ended December 31, 2005, $12.0 million of these dividends were paid in cash and $2.0 million of these dividends were paid through the issuance of additional Class B equity interests.

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

Fees and other income for the years ended December 31, 2007, 2006, and 2005, included fees relating to the following:

($ in millions)	2007	2006	2005
Structuring and diligence	$ 20.7	$ 37.3	$ 24.6
Management, consulting and other services provided to portfolio companies(1)	9.6	11.1	14.4
Commitment, guaranty and other fees from portfolio companies(2)	9.3	8.8	9.3
Fund management fees(3)	0.5		
Loan prepayment premiums	3.7	8.8	6.3
Other income	0.3	0.1	2.4
Total fees and other income(4)	$ 44.1	$ 66.1	$ 57.0

(1) 2006 includes $1.8 million in management fees from Advantage prior to its sale on March 29, 2006. See Portfolio and Investment Activity above for further discussion. 2005 includes $6.5 million in management fees from Advantage. 2006 and 2005 included management fees from Ciena of $1.7 million and $2.9 million, respectively. We did not charge Ciena management fees in 2007 or in the fourth quarter of 2006. See Private Finance Ciena

Capital LLC above.

(2) Includes guaranty and other fees from Ciena of $5.4 million, $6.1 million, and $6.3 million for 2007, 2006, and 2005, respectively. See Private Finance Ciena Capital LLC above.

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

(4) Fees and other income related to the CMBS and CDO portfolio were $4.1 million for 2005. As noted above, we sold our CMBS and CDO portfolio on May 3, 2005.

Fees and other income are generally related to specific transactions or services and therefore may vary substantially from year to year depending on the level of investment activity, the types of services provided and the level of assets in managed funds for which we earn management or other fees. Loan origination fees that represent yield enhancement on a loan are capitalized and amortized into interest income over the life of the loan.

Structuring and diligence fees primarily relate to the level of new investment originations. Private finance investments funded were $1.8 billion for the year ended December 31, 2007, as compared to $2.4 billion and $1.5 billion for the years ended December 31, 2006 and 2005, respectively. This resulted in lower structuring and diligence fees in 2007 versus 2006.

Loan prepayment premiums for the year ended December 31, 2006, included $5.0 million related to the repayment of our subordinated debt in connection with the sale of our majority equity interest in Advantage on March 29, 2006. See Portfolio and Investment Activity above for further discussion. While the scheduled maturities of private finance and commercial real estate loans generally range from five to ten years, it is not unusual for our borrowers to refinance or pay off their debts to us ahead of schedule. Therefore, we generally structure our loans to require a prepayment premium for the first three to five years of the loan. Accordingly, the amount of prepayment premiums will vary depending on the level of repayments and the age of the loans at the time of repayment.

See Portfolio and Investment Activity above for further information regarding our total interest and related portfolio income for Ciena, Mercury, and Advantage.

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

Interest Expense. The fluctuations in interest expense during the years ended December 31, 2007, 2006, and 2005, were primarily attributable to changes in the level of our borrowings under various notes payable and our revolving line of credit. Our borrowing activity and weighted average cost of debt, including fees and debt financing costs, at and for the years ended December 31, 2007, 2006, and 2005, were as follows:

($ in millions)	**2007**	**2006**	**2005**
Total outstanding debt	$ 2,289.5	$ 1,899.1	$ 1,284.8
Average outstanding debt	$ 1,924.2	$ 1,491.0	$ 1,087.1
Weighted average cost[1]	6.5%	6.5%	6.5%

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

In addition, interest expense included interest paid to the Internal Revenue Service related to installment sale gains totaling $5.8 million, $0.9 million, and $0.6 million for the years ended December 31, 2007, 2006, and 2005, respectively. See Dividends and Distributions below.

Interest expense also included interest on our obligations to replenish borrowed Treasury securities related to our hedging activities of $0.7 million and $1.4 million for the years ended December 31, 2006 and 2005, respectively.

Employee Expense. Employee expenses for the years ended December 31, 2007, 2006, and 2005, were as follows:

($ in millions)	2007	2006	2005
Salaries and employee benefits	$ 83.9	$ 73.8	$ 57.3
Individual performance award (IPA)	9.8	8.1	7.0
IPA mark to market expense (benefit)	(14.0)	2.9	2.0
Individual performance bonus (IPB)	9.5	8.1	6.9
Transition compensation, net[1]			5.1
Total employee expense[2]	$ 89.2	$ 92.9	$ 78.3
Number of employees at end of period	177	170	131

[1] Transition compensation for the year ended December 31, 2005, included $3.1 million of costs under retention agreements and $3.1 million of transition services bonuses awarded to certain employees in the commercial real estate group as a result of the sale of the CMBS and CDO portfolio. Transition compensation costs were reduced by $1.1 million for salary reimbursements from CWCapital under a transition services agreement.

[2] Excludes stock options expense. See below.

The change in salaries and employee benefits reflects the effect of compensation increases, the change in mix of employees given their area of responsibility and relevant experience level and an increase in the number of employees. The overall increase in salaries and employee benefits also reflects the competitive environment for attracting and retaining talent in the private equity industry. Salaries and employee benefits include an accrual for employee bonuses, which are generally paid annually after the completion of the fiscal year. Salaries and employee benefits included bonus expense of $40.1 million, $38.2 million, and $26.9 million for the years ended December 31, 2007, 2006, and 2005, respectively.

The IPA is an incentive compensation program for certain officers and is generally determined annually at the beginning of each year. Through December 31, 2007, the IPA was deposited into a deferred compensation trust generally in four equal installments, on a quarterly basis, in the form of cash. The trustee was required to use the cash to purchase shares of our common stock in the open market. The accounts of the trust are consolidated with our accounts. We are required to mark to market the liability of the trust and this adjustment is recorded to the IPA compensation expense. Because the IPA has been deferred compensation, the cost of this award is not a current expense for purposes of computing our taxable income until distributions are made from the trust.

On December 14, 2007, our Board of Directors made a determination that it is in Allied Capital s best interest to terminate our deferred compensation plans. The Board of Directors decision was primarily in response to increased complexity resulting from recent changes in the regulation of deferred compensation arrangements. The Board of Directors resolved that our deferred compensation plans would be terminated in accordance with the provisions of each of the plans and the accounts under the plans would be distributed to participants in full on March 18, 2008, the termination and distribution date, or as soon as reasonably practicable thereafter, in accordance with the transition rule for payment elections under Section 409A of the Internal Revenue Code of 1986. The termination and distribution of the plans was completed in the first quarter of 2008. Distributions from the plans were made in cash or shares of our common stock, net of required withholding taxes. See Results of Operations Comparison of the Three Months Ended March 31, 2008 and 2007 Employee Expense above. See also Compensation of Executive Officers and Directors Termination of Deferred Compensation Arrangements.

The assets of the rabbi trust related to The Allied Capital Corporation Non-Qualified Deferred Compensation Plans (DCPs I) were primarily invested in assets other than shares of our common stock. At December 31, 2007, the liability to participants related to DCPs I was valued at $21.1 million in the aggregate, and that liability is fully funded by assets held in the rabbi trust.

The assets of the rabbi trust related to The Allied Capital Corporation Non-Qualified Deferred Compensation Plans II(DCPs II) were primarily invested in shares of our common stock. At

December 31, 2007, the liability to participants related to DCPs II was valued at $31.4 million in the aggregate, and that liability was fully funded by assets held in the rabbi trust. At December 31, 2007, the DCPs II rabbi trust held approximately 1.4 million shares of our common stock.

The account balances in the plans accumulated as a result of prior compensation earned by the participants. The contributions to the plans reflect a combination of participant elective compensation deferrals and non-elective employer contributions, including contributions related to previously earned individual performance awards. The distribution of the DCPs I and DCPs II assets will result in a tax deduction for 2008, subject to the limitations set by Section 162(m) of the Code for persons subject to such section.

The IPB is distributed in cash to award recipients throughout the year (beginning in February of each respective year) as long as the recipient remains employed by us.

The Compensation Committee of the Board of Directors and the Board of Directors have determined the IPA and the IPB for 2008 and they are currently estimated to be approximately $9.6 million each; however, the Compensation Committee may adjust the IPA or IPB as needed, or make new awards as new officers are hired. For 2008, the Compensation Committee has determined that the IPAs will be paid in cash in two equal installments during the year, as long as the recipient remains employed by us. If a recipient terminates employment during the year, any remaining payments under the IPA or IPB would be forfeited.

Stock Options Expense. Effective January 1, 2006, we adopted Statement No. 123 (Revised 2004), *Share-Based Payment* (SFAS 123R) using the modified prospective method of application, which required us to recognize compensation costs on a prospective basis beginning January 1, 2006. Under this method, the unamortized cost of previously awarded options that were unvested as of January 1, 2006, will be recognized over the remaining service period in the statement of operations beginning in 2006, using the fair value amounts determined for proforma 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 in the consolidated statement of operations over the service period. Our employee stock options are typically granted with ratable vesting provisions, and we amortize the compensation cost over the related service period. The stock option expense for the years ended December 31, 2007 and 2006, was as follows:

($ in millions)	**2007**	**2006**
Employee Stock Option Expense:		
Options granted:		
Previously awarded, unvested options as of January 1, 2006	$ 10.1	$ 13.2
Options granted on or after January 1, 2006	10.7	2.4
Total options granted	20.8	15.6
Options cancelled in connection with tender offer (see below)	14.4	
Total employee stock option expense	$ 35.2	$ 15.6

Options Granted. In addition to the employee stock option expense for both options granted, for both the years ended December 31, 2007 and 2006, administrative expense included $0.2 million of expense related to options granted to directors during each year. Options were granted to non-officer directors in the second quarters of 2007 and 2006. Options granted to non-officer directors vest on the grant date and therefore, the full expense is recorded on the grant date.

During the second quarter of 2007, options were granted for 6.4 million shares. One-third of the options granted to employees vested on June 30, 2007; therefore, approximately one-third of the expense related to this grant, or $5.9 million, was recorded in the second quarter of 2007. Of the remaining options granted, one-half will vest on June 30, 2008, and one-half will vest on June 30, 2009. See Results of Operations for the Three Months Ended

March 31, 2008 and 2007 Stock Options Expense above for the estimate of employee-related stock option expense for future periods.

Options Cancelled in Connection with Tender Offer. On July 18, 2007, we completed a tender offer to our optionees who held vested in-the-money stock options as of June 20, 2007,where optionees received an option cancellation payment (OCP), equal to the in-the-money value of the stock options cancelled determined using a Weighted Average Market Price of $31.75 paid one-half in cash and one-half in unregistered shares of our common stock. We accepted for cancellation 10.3 million vested options held by employees and non-officer directors, which in the aggregate had a weighted average exercise price of $21.50. This resulted in a total option cancellation payment of approximately $105.6 million, of which $52.8 million was paid in cash and $52.8 million was paid through the issuance of 1.7 million unregistered shares of the Company s common stock. Our stockholders approved the issuance of the shares of our common stock in exchange for the cancellation of vested in-the-money stock options at our 2006 Annual Meeting of Stockholders. Cash payments to employee optionees were paid net of required payroll and income tax withholdings.

The OCP was equal to the in-the-money value of the stock options cancelled, determined using the Weighted Average Market Price of $31.75, and was paid one-half in cash and one-half in unregistered shares of the Company s common stock. In accordance with the terms of the tender offer, the Weighted Average Market Price represented the volume weighted average price of our common stock over the fifteen trading days preceding the first day of the offer period, or June 20, 2007. Because the Weighted Average Market Price at the commencement of the tender offer on June 20, 2007, was higher than the market price of our common stock at the close of the offer on July 18, 2007, SFAS 123R required us to record a non-cash employee-related stock option expense of $14.4 million and administrative expense related to stock options cancelled that were held by non-officer directors of $0.4 million. The same amounts were recorded as an increase to additional paid-in capital and, therefore, had no effect on our net asset value. The portion of the OCP paid in cash of $52.8 million reduced our additional paid-in capital and therefore reduced our net asset value. For income tax purposes, our tax deduction resulting from the OCP will be similar to the tax deduction that would have resulted from an exercise of stock options in the market. Any tax deduction resulting from the OCP or an exercise of stock options in the market is limited by Section 162(m) of the Code.

Administrative Expense. Administrative expenses include legal and accounting fees, valuation assistance fees, insurance premiums, the cost of leases for our headquarters in Washington, DC, and our regional offices, portfolio origination and development expenses, travel costs, stock record expenses, directors fees and related stock options expense, and various other expenses. Administrative expenses for the years ended December 31, 2007, 2006, and 2005, were as follows:

($ in millions)	2007	2006	2005
Administrative expenses	$ 44.8	$ 34.0	$ 33.3
Investigation and litigation costs	5.8	5.0	36.4
Total administrative expenses	$ 50.6	$ 39.0	$ 69.7

Administrative expenses, excluding investigation and litigation costs, for the year ended December 31, 2007, included costs of $1.4 million incurred in the first quarter of 2007 to engage a third party to conduct a review of Ciena s internal control systems. See Private Finance, Ciena Capital LLC above. In addition, administrative expenses for the year ended December 31, 2007, included $2.5 million in placement fees related to securing equity commitments to the Allied Capital Senior Debt Fund, L.P. in the second quarter of 2007. See Managed Funds Allied Capital Senior Debt Fund, L.P. above.

Administrative expenses, excluding investigation and litigation costs and the costs outlined above, were $40.9 million for the year ended December 31, 2007, which is an increase of $6.9 million from 2006. The increase was primarily due to increased expenses related to directors fees of $1.6 million, an increase in stock record expenses of $0.7 million due to the increase in our shareholder base, an increase in rent expense of $0.7 million, and an increase in costs related to evaluating potential new investments of $0.7 million. Costs related to debt investments are generally paid by the borrower, however, costs related to buyout investments are generally funded by us. Accordingly, if a prospective deal does not close, we incur expenses that are not recoverable.

Investigation and litigation costs are difficult to predict and may vary from year to year. See Legal Proceedings below.

Income Tax Expense, Including Excise Tax. Income tax expense for the years ended December 31, 2007, 2006, and 2005, was as follows:

($ in millions)	2007	2006	2005
Income tax expense (benefit)	$ (2.7)	$ 0.1	$ 5.4
Excise tax expense[1]	16.3	15.1	6.2
Income tax expense, including excise tax	$ 13.6	$ 15.2	$ 11.6

[1] While excise tax expense is presented in the Consolidated Statement of Operations as a reduction to net investment income, excise tax relates to both net investment income and net realized gains.

Our wholly-owned subsidiary, A.C. Corporation, is a corporation subject to federal and state income taxes and records a benefit or expense for income taxes as appropriate based on its operating results in a given period.

Our estimated annual taxable income for 2007 exceeded our dividend distributions to shareholders from such taxable income in 2007, and such estimated excess taxable income will be distributed in 2008. Therefore, we will generally be required to pay an excise tax equal to 4% of the amount by which 98% of our annual taxable income exceeds the distributions for the year. We have recorded an estimated excise tax of $16.3 million for the year ended December 31, 2007. See Dividends and Distributions.

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, which clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes.* This interpretation is effective for fiscal years beginning after December 15, 2006. The adoption of this interpretation did not have a significant effect on our consolidated financial position or our results of operations.

Realized Gains and Losses. Net realized gains primarily result from the sale of equity securities associated with certain private finance investments and the realization of unamortized discount resulting from the sale and early repayment of private finance loans and commercial mortgage loans, offset by losses on investments. In 2005, net realized gains also resulted from the sale of real estate-related CMBS bonds and CDO bonds and preferred shares. Net realized gains for the years ended December 31, 2007, 2006, and 2005, were as follows:

($ in millions)	2007	2006	2005
Realized gains	$ 400.5	$ 557.5	$ 343.1
Realized losses	(132.0)	(24.2)	(69.6)
Net realized gains	$ 268.5	$ 533.3	$ 273.5

When we exit an investment and realize a gain or loss, we make an accounting entry to reverse any unrealized appreciation or depreciation, respectively, we had previously recorded to reflect the appreciated or depreciated value of the investment. For the years ended December 31, 2007, 2006, and 2005, we

reversed previously recorded unrealized appreciation or depreciation when gains or losses were realized as follows:

($ in millions)	2007	2006	2005[1]
Reversal of previously recorded net unrealized appreciation associated with realized gains	$ (332.6)	$ (501.5)	$ (108.0)
Reversal of previously recorded net unrealized depreciation associated with realized losses	139.8	22.5	68.0
Total reversal	$ (192.8)	$ (479.0)	$ (40.0)

(1) Includes the reversal of net unrealized appreciation of $6.5 million on the CMBS and CDO assets sold and the related hedges. The net unrealized appreciation recorded on these assets prior to their sale was determined on an individual security-by-security basis. The net gain realized upon the sale of $227.7 million reflects the total value received for the portfolio as a whole.

Realized gains for the years ended December 31, 2007, 2006, and 2005, were as follows:

($ in millions)

2007

Portfolio Company	Amount
Private Finance:	
Mercury Air Centers, Inc.	$ 262.4
HMT, Inc.	39.9
Healthy Pet Corp.	36.6
Palm Coast Data, LLC	20.0
Woodstream Corporation	14.6
Wear Me Apparel Corporation	6.1
Mogas Energy, LLC	5.7
Tradesmen International, Inc.	3.8
ForeSite Towers, LLC	3.8
Advantage Sales & Marketing, Inc.	3.4
Geotrace Technologies, Inc.	1.1
Other	3.0
Total private finance	400.4
Commercial Real Estate:	
Other	0.1
Total commercial real estate	0.1
Total realized gains	$ 400.5

2006

Portfolio Company	Amount
Private Finance:	
Advantage Sales & Marketing, Inc.[1]	$ 434.4
STS Operating, Inc.	94.8
Oriental Trading Company, Inc.	8.9
Advantage Sales & Marketing, Inc.[2]	4.8
United Site Services, Inc.	3.3
Component Hardware Group, Inc.	2.8
Opinion Research Corporation	1.9
Nobel Learning Communities, Inc.	1.5
MHF Logistical Solutions, Inc.	1.2
The Debt Exchange, Inc.	1.1
Other	1.5
Total private finance	556.2
Commercial Real Estate:	
Other	1.3
Total commercial real estate	1.3
Total realized gains	$ 557.5

2005

Portfolio Company	Amount
Private Finance:	
Housecall Medical Resources, Inc.	$ 53.7
Fairchild Industrial Products Company	16.2
Apogen Technologies Inc.	9.0
Polaris Pool Systems, Inc.	7.4
MasterPlan, Inc.	3.7
U.S. Security Holdings, Inc.	3.3
Ginsey Industries, Inc.	2.8
E-Talk Corporation	1.6
Professional Paint, Inc.	1.6
Oriental Trading Company, Inc.	1.0
Woodstream Corporation	0.9
Impact Innovations Group, LLC	0.8
DCS Business Services, Inc.	0.7
Other	3.4
Total private finance	106.1
Commercial Real Estate:	

CMBS/CDO assets, net[3]		227.7
Other		9.3
Total commercial real estate		237.0
Total realized gains	$	343.1

(1) Represents the realized gain on our majority equity investment only. See Private Finance above.
(2) Represents a realized gain on our minority equity investment only. See Private Finance above.
(3) Net of net realized losses from related hedges of $0.7 million for the year ended December 31, 2005.

Realized losses for the years ended December 31, 2007, 2006, and 2005, were as follows:
($ in millions)

2007

Portfolio Company		**Amount**
Private Finance:		
Global Communications, LLC	$	34.3
Jakel, Inc.		24.8
Startec Global Communications, Inc.		20.2
Gordian Group, Inc.		19.3
Powell Plant Farms, Inc.		11.6
Universal Environmental Services, LLC		8.6
PresAir, LLC		6.0
Legacy Partners Group, LLC		5.8
Alaris Consulting, LLC		1.0
Other		0.4
Total realized losses	$	132.0

2006

Portfolio Company		**Amount**
Private Finance:		
Staffing Partners Holding Company, Inc.	$	10.6
Acme Paging, L.P.		4.7
Cooper Natural Resources, Inc.		2.2
Aspen Pet Products, Inc.		1.6
Nobel Learning Communities, Inc.		1.4
Other		1.6
Total private finance		22.1
Commercial Real Estate:		
Other		2.1
Total commercial real estate		2.1
Total realized losses	$	24.2

2005

Portfolio Company		**Amount**

Private Finance:		
Norstan Apparel Shops, Inc.	$	18.5
Acme Paging, L.P.		13.8
E-Talk Corporation		9.0
Garden Ridge Corporation		7.1
HealthASPex, Inc.		3.5
MortgageRamp, Inc.		3.5
Maui Body Works, Inc.		2.7
Packaging Advantage Corporation		2.2
Other		3.7
Total private finance		64.0
Commercial Real Estate:		
Other		5.6
Total commercial real estate		5.6
Total realized losses	$	69.6

Change in Unrealized Appreciation or Depreciation. We determine the value of each investment in our portfolio on a quarterly basis, and changes in value result in unrealized appreciation or depreciation being recognized in our statement of operations. Value, as defined in Section 2(a)(41) of the Investment Company Act of 1940, is (i) the market price for those securities for which a market quotation is readily available and (ii) for all other securities and assets, fair value is as determined in good faith by the Board of Directors. Since there is typically no readily available market value for the investments in our portfolio, we value substantially all of our portfolio investments at fair value as determined in good faith by the Board of Directors pursuant to our valuation policy and a consistently applied valuation process. At December 31, 2007, portfolio investments recorded at fair value were approximately 92% of our total assets. Because of the inherent uncertainty of determining the fair value of investments that do not have a readily available market value, the fair value of our investments determined in good faith by the Board of Directors may differ significantly from the values that would have been used had a ready market existed for the investments, and the differences could be material.

There is no single standard for determining fair value in good faith. As a result, determining fair value requires that judgment be applied to the specific facts and circumstances of each portfolio investment while employing a consistently applied valuation process for the types of investments we make. Unlike banks, we are not permitted to provide a general reserve for anticipated loan losses. Instead, we are required to specifically value each individual investment on a quarterly basis. We will record unrealized depreciation on investments when we determine that the fair value of a security is less than its cost basis, and we will record unrealized appreciation when we determine that the fair value is greater than its cost basis. Changes in fair value are recorded in the statement of operations as net change in unrealized appreciation or depreciation.

As a business development company, we have invested in illiquid securities including debt and equity securities of companies, CLO bonds and preferred shares/income notes, CDO bonds and investment funds. The structure of each debt and equity security is specifically negotiated to enable us to protect our investment and maximize our returns. We include many terms governing interest rate, repayment terms, prepayment penalties, financial covenants, operating covenants, ownership parameters, dilution parameters, liquidation preferences, voting rights, and put or call rights. Our investments may be subject to certain restrictions on resale and generally have no established trading market.

Because of the type of investments that we make and the nature of our business, our valuation process requires an analysis of various factors. Our fair value methodology includes the examination of, among other things, the underlying investment performance, financial condition, and market changing events that impact valuation.

In the first quarter of 2008, we adopted Statement No. 157, *Fair Value Measurements,* on a prospective basis. See Results of Operations Comparison of the Three Months Ended March 31, 2008 and 2007 Change in Unrealized Appreciation or Depreciation above.

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

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

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

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

CLO/CDO Assets are carried at fair value, which is based on a discounted cash flow model that utilizes prepayment, re-investment and loss assumptions based on historical experience and projected performance, economic factors, the characteristics of the underlying cash flow and comparable yields for similar bonds and preferred shares/income notes, when available. We recognize unrealized appreciation or depreciation on our 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 or loss assumptions in the underlying collateral pool. We determine the fair value of our CLO/CDO Assets on an individual security-by-security basis. If we were to sell a group of these CLO/CDO Assets in a pool in one or more transactions, the total value received for that pool may be different than the sum of the fair values of the individual assets.

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

We currently intend to continue to work with third-party consultants to obtain assistance in determining fair value for a portion of the private finance portfolio each quarter. We work with these consultants to obtain assistance as additional support in the preparation of our internal valuation analysis. In addition, we may receive third-party assessments of a particular private finance portfolio company s value in the ordinary course of business, most often in the context of a prospective sale transaction or in the context of a bankruptcy process.

The valuation analysis prepared by management is submitted to our Board of Directors who is ultimately responsible for the determination of fair value of the portfolio in good faith. Valuation assistance from Duff & Phelps, LLC (Duff & Phelps) for our private finance portfolio consisted of certain limited procedures (the Procedures) we identified and requested them to perform. Based upon the performance of the Procedures on a selection of our final portfolio company valuations, Duff & Phelps concluded that the fair value of those portfolio companies subjected to the Procedures did not appear unreasonable. In addition, we also received third-party valuation assistance from other third-party consultants for certain private finance portfolio companies. For the years ended December 31, 2007, 2006, and 2005, we received third-party valuation assistance as follows:

	2007			
	Q4	**Q3**	**Q2**	**Q1**
Number of private finance portfolio companies reviewed	112	135	92	88
Percentage of private finance portfolio reviewed at value	91.1%	92.1%	92.1%	91.8%

	2006			
	Q4	**Q3**	**Q2**	**Q1**
Number of private finance portfolio companies reviewed	81	105	78	78
Percentage of private finance portfolio reviewed at value	82.9%	86.5%	89.6%	87.0%

	2005

	Q4	**Q3**	**Q2**	**Q1**
Number of private finance portfolio companies reviewed	80	89	72	36
Percentage of private finance portfolio reviewed at value	92.4%	89.3%	83.0%	74.5%

Professional fees for third-party valuation assistance for the years ended December 31, 2007, 2006, and 2005, were $1.8 million, $1.5 million, and $1.4 million, respectively.

Net Change in Unrealized Appreciation or Depreciation. Net change in unrealized appreciation or depreciation for the years ended December 31, 2007, 2006, and 2005, consisted of the following:

($ in millions)	2007[1]	2006[1]	2005[1]
Net unrealized appreciation (depreciation)[2]	$ (63.4)	$ 1.6	$ 502.1
Reversal of previously recorded unrealized appreciation associated with realized gains	(332.6)	(501.5)	(108.0)
Reversal of previously recorded unrealized depreciation associated with realized losses	139.8	22.5	68.0
Net change in unrealized appreciation or depreciation	$ (256.2)	$ (477.4)	$ 462.1

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

(2) The sale of certain of our portfolio investments to Goldman Sachs that occurred in the first quarter of 2008 provided transaction values for 59 portfolio investments that were used in the December 31, 2007, valuation process.

Valuation of Ciena Capital LLC. Our investment in Ciena totaled $327.8 million at cost and $68.6 million at value, which included unrealized depreciation of $259.2 million, at December 31, 2007, and $295.3 million at cost and $210.7 million at value, which included unrealized depreciation of $84.6 million, at December 31, 2006.

Ciena relies on the asset-backed securitization market to finance its loan origination activity. That financing source is an unreliable one in the current capital markets, and as a result, Ciena has significantly curtailed loan origination activity. To value our investment at December 31, 2007, we determined that no value could be attributed to Ciena s origination platform or enterprise due to the state of the securitization markets, among other factors. In addition, Ciena s book value declined during the quarter ended December 31, 2007. We valued our investment in Ciena at December 31, 2007 solely based on the estimated realizable value of Ciena s net assets, including the estimated realizable value of the cash flows generated from Ciena s retained interests in its current servicing portfolio, which includes portfolio servicing fees as well as cash flows from Ciena s equity investments in its securitizations and its interest-only strip. This resulted in a value to our investment, after repayment of senior debt outstanding, of $68.6 million at December 31, 2007.

We also continued to consider Ciena s current regulatory issues and ongoing investigations and litigation in performing the valuation analysis at December 31, 2007. (See Private Finance, Ciena Capital LLC above.)

Net change in unrealized appreciation or depreciation included a net decrease of $174.5 million and $142.3 million for the years ended December 31, 2007 and 2006, respectively, and a net increase of $2.9 million for the year ended December 31, 2005, related to our investment in Ciena. We received valuation assistance from Duff & Phelps for our investment in Ciena at December 31, 2007, 2006, and 2005. See Valuation Methodology Private Finance above for further discussion of the third-party valuation assistance we received.

Per Share Amounts. All per share amounts included in the Management s Discussion and Analysis of Financial Condition and Results of Operations section have been computed using the weighted average common shares used to compute diluted earnings per share, which were 154.7 million, 145.6 million, and 137.3 million for the years ended December 31, 2007, 2006, and 2005, respectively.

OTHER MATTERS

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

Dividends are paid to shareholders from taxable income. Taxable income generally differs from net income for financial reporting purposes due to temporary and permanent differences in the recognition of income and expenses, and generally excludes net unrealized appreciation or depreciation, as gains or losses generally are not included in taxable income until they are realized. In addition, gains realized for financial reporting purposes may differ from gains included in taxable income as a result of our election to recognize gains using installment sale treatment, which generally results in the deferment of gains for tax purposes until notes or other amounts, including amounts held in escrow, received as consideration from the sale of investments are collected in cash. See Dividends and Distributions below.

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

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

DIVIDENDS AND DISTRIBUTIONS

Dividends to common shareholders were $0.65 per common share for the first quarter of 2008 and $0.63 per common share for the first quarter of 2007. Total regular quarterly dividends to common shareholders were $2.57, $2.42, and $2.30 per common share for the years ended December 31, 2007, 2006, and 2005, respectively. An extra cash dividend of $0.07, $0.05, and $0.03 per common share was declared during 2007, 2006, and 2005, respectively, and was paid to shareholders on December 27, 2007, January 19, 2007, and January 27, 2006, respectively. The Board of Directors has declared a dividend of $0.65 per common share for the second quarter of 2008.

Our Board of Directors reviews the dividend rate quarterly, and may adjust the quarterly dividend throughout the year. Dividends are declared considering our estimate of annual taxable income available for distribution to shareholders and the amount of taxable income carried over from the prior year for distribution in the current year. Our goal is to declare what we believe to be sustainable increases in our regular quarterly dividends. To the extent that we earn annual taxable income in excess of dividends paid from such taxable income for the year, we may carry over the excess taxable income into the next year and such excess income will be available for distribution in the next year as permitted under the Code (see discussion below). Such income will be treated under the Code as having been distributed during the prior year for purposes of our qualification for RIC tax treatment for such year. The maximum amount of excess taxable income that we may carry over for distribution in the next year under the Code is the total amount of dividends paid in the following year, subject to certain declaration and payment guidelines. Excess taxable income carried over and paid out in the next year is generally subject to a nondeductible 4% excise tax. We believe that carrying over excess taxable income into future periods may provide increased visibility with respect to taxable earnings available to pay the regular quarterly dividend.

Taxable income includes our taxable interest, dividend and fee income, as well as taxable net capital gains. Taxable income generally differs from net income for financial reporting purposes due to temporary and permanent differences in the recognition of income and expenses, and generally excludes net unrealized appreciation or depreciation, as gains or losses are not included in taxable income until they are realized. In addition, gains realized for financial reporting purposes may differ from gains included in taxable income as a result of our election to recognize gains using installment sale treatment, which generally results in the deferment of gains for tax purposes until notes or other amounts, including amounts held in escrow, received as consideration from the sale of investments are collected in cash. Taxable income includes non-cash income, such as changes in accrued and reinvested interest and dividends, which includes contractual payment-in-kind interest, and the amortization of discounts and fees. Cash collections of income resulting from contractual payment-in-kind interest or the amortization of discounts and fees generally occur upon the repayment of the loans or debt securities that include such items. Non-cash taxable income is reduced by non-cash expenses, such as realized losses and depreciation and amortization expense.

The summary of our taxable income and distributions of such taxable income for the years ended December 31, 2007, 2006, and 2005, is as follows:

($ in millions)	**2007 (ESTIMATED)[1]**	**2006**	**2005**
Taxable income[2]	$ 407.6	$ 601.2	$ 445.0
Taxable income earned in current year and carried forward for distribution in next year	(403.1)	(402.8)	(156.5)
Taxable income earned in prior year and carried forward and distributed in current year	402.8	156.5	26.0
Total dividends to common shareholders	$ 407.3	$ 354.9	$ 314.5

(1) Our taxable income for 2007 is an estimate and will not be finally determined until we file our 2007 tax return in September 2008. Therefore, the final taxable income and the taxable income earned in 2007 and carried forward for distribution in 2008 may be different than the estimate above. See Risk Factors above and Note 10, Dividends and Distributions and Taxes of our Notes to our annual Consolidated Financial Statements.

(2) See Note 10, Dividends and Distributions and Taxes of our Notes to our annual Consolidated Financial Statements for further information on the differences between net income for book purposes and taxable income.

Our estimated annual taxable income for 2007 exceeded our dividend distributions to shareholders for 2007 from such taxable income, and, therefore, we have carried over excess taxable income, which is currently estimated to be $403.1 million, for distribution to shareholders in 2008. Estimated excess taxable income for 2007 represents approximately $50.0 million of ordinary income and approximately $353.1 million of net long-term capital gains. The maximum amount of excess taxable income that may be carried over for distribution in the next year under the Code is the total amount of dividends paid in the following year, subject to certain declaration and payment guidelines. Excess taxable income carried over and paid out in the next year is generally subject to a 4% excise tax. For the years ended December 31, 2007, 2006, and 2005, excise tax expense was $16.3 million, $15.1 million, and $6.2 million, respectively. See Other Matters Regulated Investment Company Status above.

Dividends paid in 2008 will first be paid out of the excess taxable income carried over from 2007. Given our regular quarterly dividend payout, which for the first quarter of 2008 was $108.1 million, we expect that a majority of the 2008 dividend payments will be made from excess 2007 taxable earnings. Given the significant amount of estimated excess taxable income carried forward from 2007 for distribution in 2008, we currently expect that our excess taxable income carried over from 2007 plus our estimated annual taxable income for 2008 will be in excess of our estimated dividend distributions to shareholders in 2008, therefore, we expect to carry over excess taxable income earned in 2008 for distribution to shareholders in 2009. We expect that we will generally be required to pay a 4% excise tax on the excess of 98% of our taxable income for 2008 over the amount of actual distributions from such taxable income in 2008. For the three months ended March 31, 2008, we have recorded an excise tax of $2.3 million. Excise taxes are accrued based upon estimated excess taxable income as estimated taxable income is earned, therefore, the excise tax accrued to date in 2008 may be adjusted as appropriate in the remainder of 2008 to reflect changes in our estimate of the carry over amount and additional excise tax may be accrued during the remainder of 2008 as additional excess taxable income is earned, if any. Our ability to earn the estimated annual taxable income for 2008 depends on many factors, including our ability to make new investments at attractive yields, the level of repayments in the portfolio, the realization of gains or losses from portfolio exits, and the level of operating expenses incurred. See Management s Discussion and Analysis of Financial Condition and Results of Operations and Risk Factors.

In addition, we currently estimate that we have cumulative deferred taxable income related to installment sale gains of approximately $234.5 million as of December 31, 2007, which is composed of cumulative deferred taxable income of $211.5 million as of December 31, 2006, and approximately $23.0 million for the year ended December 31, 2007. These gains have been recognized for financial reporting purposes in the respective years they were realized, but generally will be deferred for tax purposes until the notes or other amounts received from the sale of the related investments are collected in cash. The installment sale gains for 2007 are estimates and will not be finally determined until we file our 2007 tax return in September 2008. See Other Matters Regulated Investment Company Status above.

To the extent that installment sale gains are deferred for recognition in taxable income, we pay interest to the Internal Revenue Service. Installment-related interest expense for the three months ended March 31, 2008 and 2007, and for the years ended December 31, 2007, 2006, and 2005, was $1.9 million, $0.3 million, $5.8 million, $0.9 million, and $0.6 million, respectively. This interest is included in interest expense in our Consolidated Statement of Operations.

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

At March 31, 2008, and December 31, 2007 and 2006, our cash, U.S. Treasury bills, investments in money market and other securities, total assets, total debt outstanding, total shareholders equity, debt to equity ratio and asset coverage for senior indebtedness were as follows:

($ in millions)	2008	2007	2006
Cash, U.S. Treasury bills, investments in money market and other securities (including U.S. Treasury bills, money market and other securities: 2008-$120.4, 2007-$201.2; 2006-$202.2)	$ 201.6	$ 204.8	$ 203.9
Total assets	$ 5,082.2	$ 5,214.6	$ 4,887.5
Total debt outstanding	$ 2,191.6	$ 2,289.5	$ 1,899.1
Total shareholders equity	$ 2,828.4	$ 2,771.8	$ 2,841.2
Debt to equity ratio	0.77	0.83	0.67
Asset coverage ratio(1)	229%	221%	250%

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

Cash generated from the portfolio includes cash flow from net investment income and net realized gains and principal collections related to investment repayments or sales. Cash flow provided by our operating activities before new investment activity for the three months ended March 31, 2008 and 2007, and for the years ended December 31, 2007, 2006, and 2005, was as follows:

	For the Three Months Ended March 31,		For the Year Ended December 31,		
	2008	2007	2007	2006	2005

($ in millions)					
Net cash provided by (used in) operating activities	$ 111.3	$ 19.4	$ (112.2)	$ (597.5)	$ 116.0
Add: portfolio investments funded	275.1	170.2	1,846.0	2,257.8	1,668.1
Total cash provided by operating activities before new investments	$ 386.4	$ 189.6	$ 1,733.8	$ 1,660.3	$ 1,784.1

In addition to the net cash flow provided by our operating activities before funding investments, we have sources of liquidity through our cash, U.S. Treasury bills, investments in money market and other securities and revolving line of credit as discussed below.

At March 31, 2008, and December 31, 2007 and 2006, the value and yield of the cash, U.S. Treasury bills, investments in money market and other securities were as follows:

	2008		2007		2006	
($ in millions)	Value	Yield	Value	Yield	Value	Yield
U.S. Treasury bills[1]	$ 120.0	1.6%	$	%	$	%
Money market securities	0.4	3.2%	201.2	4.6%	161.6	5.3%
Certificate of Deposit					40.6	5.6%
Cash	81.2	1.5%	3.6	2.9%	1.7	3.8%
Total	$ 201.6	1.5%	$ 204.8	4.6%	$ 203.9	5.3%

(1) The Treasury bills matured in April 2008. We reinvested the proceeds from the matured Treasury bills in short-term Treasury bills of $100 million and cash of $20 million.

We maintain this pool of liquid assets within our balance sheet given that our investment portfolio is primarily composed of private, illiquid assets for which there is no readily available market. We assess the amount held in and the composition of these investments throughout the year. As the capital markets became increasingly uncertain in March 2008, we moved our liquidity portfolio entirely into cash and very short-term treasuries.

We invest otherwise uninvested cash in U.S. government- or agency-issued or guaranteed securities that are backed by the full faith and credit of the United States, or in high quality, short-term securities. We place our cash with financial institutions and, at times, cash held in checking accounts in financial institutions may be in excess of the Federal Deposit Insurance Corporation insured limit.

We employ an asset-liability management approach that focuses on matching the estimated maturities of our investment portfolio to the estimated maturities of our borrowings. We use our revolving line of credit facility as a means to finance our business pending long-term financing in the form of debt or equity capital, which may or may not result in temporary differences in the matching of estimated maturities. We evaluate our interest rate exposure on an ongoing basis. Generally, we seek to fund our primarily fixed-rate debt portfolio and our equity portfolio with fixed-rate debt or equity capital. To the extent deemed necessary, we may hedge variable and short-term interest rate exposure through interest rate swaps or other techniques.

During the three months ended March 31, 2008 and 2007, and the years ended December 31, 2007 and 2006, we sold new equity of $170.9 million, $93.8 million, $171.3 million and $295.8 million, respectively, in public offerings. We did not sell new equity in a public offering during the year ended December 31, 2005. During the year ended December 31, 2005, we issued $7.2 million of our common stock as consideration for investments. In addition, shareholders equity increased through capital share transactions by $3.9 million, $5.8 million, $31.5 million, $27.7 million, and $77.5 million through the exercise of stock options, the collection of notes receivable from the sale of common stock, and the issuance of shares through our dividend reinvestment plan for the three months ended March 31, 2008 and 2007, and the years ended December 31, 2007, 2006, and 2005, respectively. In addition, shareholders equity increased by $26.4 million during the three months ended March 31, 2008, as a result of the distribution of the common stock held in deferred compensation trusts. See Note 8, Employee Compensation Plans from our Notes to Consolidated Financial Statements for the first quarter of 2008. For the year ended December 31, 2007, shareholders equity decreased by $52.8 for the cash portion of the option cancellation payment made in connection with out tender offer. See Results of Operations, Stock Option Expense, Options Cancelled in Connection with Tender Offer. See Note 13, Financial Highlights from our Notes to the Consolidated Financial Statements for further detail on the change in shareholders equity for the periods.

We generally target a debt to equity ratio ranging between 0.50:1.00 to 0.70:1.00 because we believe that it is prudent to operate with a larger equity capital base and less leverage. At March 31, 2008, our debt to equity ratio net of cash, U.S. Treasury bills and other securities was 0.70:1.00. In April 2008, we completed a public offering of 3.2 million shares of common stock for net proceeds, after the underwriting discount and estimated offering expenses, of $56.3 million.

At March 31, 2008, and December 31, 2007 and 2006, we had outstanding debt as follows:

	2008				2007				2006			
($ in millions)	Facility Amount	Amount Outstanding	Annual Interest Cost[1]	Annual Return to Cover Interest Payments[2]	Facility Amount	Amount Outstanding	Annual Interest Cost[1]	Annual Return to Cover Interest Payments[2]	Facility Amount	Amount Outstanding	Annual Interest Cost[1]	Annual Return to Cover Interest Payments[2]
Notes payable and debentures:												
Privately issued unsecured notes payable	$ 1,042.8	$ 1,042.8	6.1%	1.3%	$ 1,042.2	$ 1,042.2	6.1%	1.2%	$ 1,041.4	$ 1,041.4	6.1%	1.3%
Publicly issued unsecured notes payable	880.0	880.0	6.7%	1.2%	880.0	880.0	6.7%	1.1%	650.0	650.0	6.6%	0.9%
Total notes payable and debentures	1,922.8	1,922.8	6.4%	2.4%	1,922.2	1,922.2	6.4%	2.3%	1,691.4	1,691.4	6.3%	2.2%
Revolving line of credit	922.5	268.8(5)	3.8%(3)	0.3%	922.5	367.3	5.9%(3)	0.5%	922.5	207.7	6.4%(3)	0.3%
Total debt	$ 2,845.3	$ 2,191.6	6.2%(4)	2.7%	$ 2,844.7	$ 2,289.5	6.5%(4)	2.8%	$ 2,613.9	$ 1,899.1	6.5%(4)	2.5%

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

(2) The annual return to cover interest payments is calculated as the March 31, 2008, December 31, 2007 and 2006, annualized cost of debt per class of financing outstanding divided by total assets at March 31, 2008, December 31, 2007 and 2006, respectively.

(3) The annual interest cost reflects the interest rate payable for borrowings under the revolving line of credit in effect at the balance sheet date. In addition to the current interest rate payable, there were annual costs of commitment fees, other facility fees and amortization of debt financing costs of $3.7 million, $3.7 million and $3.9 million at March 31, 2008, December 31, 2007 and 2006, respectively.

(4) The annual interest cost for total debt includes the annual cost of commitment fees and the amortization of debt financing costs on the revolving line of credit and other facility fees regardless of the amount outstanding on the facility as of the balance sheet date. The annual interest cost reflects the facilities in place on the balance sheet date.

(5) On April 9, 2008, we entered into a three-year unsecured revolving line of credit with total commitments of $632.5 million, which replaced our previous line of credit. Under this new revolving line of credit, in addition to the current interest rate payable, the annual costs of commitment fees, other facility fees and amortization of debt financing costs will be approximately $6.7 million. See discussion below.

Privately Issued Unsecured Notes Payable. We have privately issued unsecured long-term notes to institutional investors, primarily insurance companies. The notes have five- or seven-year maturities and fixed rates of interest. The notes generally require payment of interest only semi-annually, and all principal is due upon maturity. At March 31, 2008, the notes had maturities from May 2008 to May 2013. The notes may be prepaid in whole or in part, together with an interest premium, as stipulated in the note agreements.

We have issued five-year unsecured long-term notes denominated in Euros and Sterling for a total U.S. dollar equivalent of $15.2 million. The notes have fixed interest rates and have substantially the same terms as our other unsecured notes. The Euro notes require annual interest payments and the Sterling notes require semi-annual interest payments until maturity. These notes mature in March 2009. Simultaneous with issuing the notes, we entered into a cross currency swap with a financial institution which fixed our interest and principal payments in U.S. dollars for the life of the debt.

Publicly Issued Unsecured Notes Payable. At March 31, 2008, we had outstanding publicly issued unsecured notes as follows:

($ in millions)	Amount	Maturity Date
6.625% Notes due 2011	$ 400.0	July 15, 2011
6.000% Notes due 2012	250.0	April 1, 2012
6.875% Notes due 2047	230.0	April 15, 2047
Total	$ 880.0	

The 6.625% Notes due 2011 and the 6.000% Notes due 2012 require payment of interest only semi-annually, and all principal is due upon maturity. We have the option to redeem these notes in whole or in part, together with a redemption premium, as stipulated in the notes.

On March 28, 2007, we completed the issuance of $200.0 million of 6.875% Notes due 2047 for net proceeds of $193.0 million. In April 2007, we issued additional notes, through an over-allotment option, totaling $30.0 million for net proceeds of $29.1 million. Net proceeds are net of underwriting discounts and estimated offering expenses. The notes are listed on the New York Stock Exchange under the trading symbol AFC.

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

Revolving Line of Credit. At March 31, 2008, and December 31, 2007 and 2006, we had an unsecured revolving line of credit with a committed amount of $922.5 million that was scheduled to expire on September 30, 2008.

On April 9, 2008, we entered into a three-year unsecured revolving line of credit with total commitments of $632.5 million, with Bank of America, N.A., as a lender and as administrative agent, and the other lenders thereunder, which replaced our previous revolving line of credit. We may obtain additional commitments up to a total committed facility of $1.5 billion, subject to customary conditions. The revolving line of credit expires on April 11, 2011.

At our option, borrowings under the revolving line of credit effective April 9, 2008, generally bear interest at a rate per annum equal to (i) LIBOR (for the period selected by us) plus 2.00% or (ii) the higher of the Federal Funds rate plus 0.50% or the Bank of America N.A. prime rate. The revolving line of credit requires the payment of an annual commitment fee equal to 0.50% of the committed amount (whether used or unused). The revolving line of credit generally requires payments of interest at the end of each LIBOR interest period, but no less frequently than quarterly, on LIBOR-based loans, and monthly payments of interest on other loans. All principal is due upon maturity.

The annual cost of commitment fees, other facility fees and amortization of debt financing costs prior to entering into the new three-year facility in April 2008, was $3.7 million at March 31, 2008. Subsequent to entering into the new facility in April 2008, the annual cost of commitment fees, other facility fees and amortization of debt financing costs will be approximately $6.7 million.

At April 9, 2008, there was $210.8 million outstanding on our unsecured revolving line of credit. The amount available under the line at April 9, 2007, was $325.4 million, net of amounts committed for standby letters of credit of $96.3 million. Net repayments on the revolving line of credit for the three months ended March 31, 2008, were $98.5 million. Net borrowings under the revolving lines of credit for the years ended December 31, 2007 and 2006, were $159.5 million and $116.0 million, respectively.

Covenant Compliance. We have various financial and operating covenants required by the revolving line of credit and the privately issued unsecured notes payable outstanding at March 31, 2008, December 31, 2007 and 2006. These covenants require us to maintain certain financial ratios, including asset coverage, debt to equity and interest coverage, and a minimum net worth. These credit facilities provide for customary events of default, including, but not limited to, payment defaults, breach of representations or covenants, cross-defaults, bankruptcy events, failure to pay judgments, attachment of our assets, change of control and the issuance of an order of dissolution. Certain of these events of default are subject to notice and cure periods or materiality thresholds. Our credit facilities limit our ability to declare dividends if we default under certain provisions. As of March 31, 2008, and December 31, 2007 and 2006, we were in compliance with these covenants. The financial and operating covenants under the new revolving line of credit are substantially similar to the previous facility.

We have certain financial and operating covenants that are required by the publicly issued unsecured notes payable, including that we will maintain a minimum ratio of 200% of total assets to total borrowings, as required by the Investment Company Act of 1940, as amended, while these notes are outstanding. At March 31, 2008, December 31, 2007 and 2006, we were in compliance with these covenants.

Contractual Obligations. The following table shows our significant contractual obligations for the repayment of debt and payment of other contractual obligations as of March 31, 2008.

		Payments Due By Year					
($ in millions)	Total	2008	2009	2010	2011	2012	After 2012
Unsecured notes payable	$ 1,922.8	$ 153.0	$ 270.3	$ 408.0	$ 472.5	$ 339.0	$ 280.0
Revolving line of credit[1]	268.8	268.8					
Operating leases	19.1	3.3	4.6	4.5	1.8	1.8	3.1
Total contractual obligations	$ 2,210.7	$ 425.1	$ 274.9	$ 412.5	$ 474.3	$ 340.8	$ 283.1

(1) At March 31, 2008, $268.8 million was borrowed on the revolving line of credit and $96.3 million of standby letters of credit were issued under the credit facility. In April 2008, we entered into a new unsecured revolving line of credit, which replaced the previous revolving line of credit, with total commitments of $632.5 million. See Revolving Line of Credit above.

Off-Balance Sheet Arrangements

In the ordinary course of business, we have issued guarantees and have extended standby letters of credit through financial intermediaries on behalf of certain portfolio companies. We have generally issued guarantees of debt and lease obligations. Under these arrangements, we would be required to make payments to third-party beneficiaries if the portfolio companies were to default on their related payment obligations. The following table shows our guarantees and standby letters of credit that may have the effect of creating, increasing, or accelerating our liabilities as of March 31, 2008.

		Amount of Commitment Expiration Per Year					
($ in millions)	Total	2008	2009	2010	2011	2012	After 2012
Guarantees	$ 394.0	$ 0.3	$ 387.3	$	$ 4.4	$ 0.1	$ 1.9
Standby letters of credit[1]	96.3	96.3					
Total commitments[2]	$ 490.3	$ 96.6	$ 387.3	$	$ 4.4	$ 0.1	$ 1.9

(1) Standby letters of credit are issued under our revolving line of credit that expires in September 2008. Therefore, unless a standby letter of credit is set to expire at an earlier date, we have assumed that the standby letters of credit will expire contemporaneously with the expiration of our line of credit that was in effect at March 31, 2008, which was scheduled to expire in September 2008. In April 2008, we entered into a new three-year revolving line of credit that expires in April 2011.

(2) Our most significant commitments relate to our investment in Ciena Capital LLC (Ciena), which commitments totaled $444.3 million at March 31, 2008. At March 31, 2008, the principal components of these guarantees

included a guarantee of 100% of the outstanding total obligations on Ciena s revolving line of credit, which matures in March 2009, for a total guaranteed amount of $384.8 million and standby letters of credit issued totaling $59.5 million in connection with term securitizations completed by Ciena. See Private Finance, Ciena Capital LLC above for further discussion.

In addition, we had outstanding commitments to fund investments totaling $885.3 million at March 31, 2008, including $845.3 million related to private finance investments and $40.0 million related to commercial real estate finance investments. Outstanding commitments related to private finance investments included $493.5 million to the Unitranche Fund LLC, which we believe will be funded over a two to three year period as investments are funded by the Unitranche Fund. See Portfolio and Investment Activity Outstanding Commitments above. We intend to fund these commitments and prospective investment opportunities with existing cash, through cash flow from operations before new investments, through borrowings under our line of credit or other long-term debt agreements, or through the sale or issuance of new equity capital.

CRITICAL ACCOUNTING POLICIES

The consolidated financial statements are based on the selection and application of critical accounting policies, which require management to make significant estimates and assumptions. Critical accounting policies are those that are both important to the presentation of our financial condition and results of

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operations and require management s most difficult, complex, or subjective judgments. Our critical accounting policies are those applicable to the valuation of investments, certain revenue recognition matters and certain tax matters as discussed below.

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

We adopted SFAS 157 on a prospective basis in the first quarter of 2008. In accordance with the Statement, we have considered our principal market, or the market in which we exit our portfolio investments with the greatest volume and level of activity. SFAS 157 requires us to assume that the portfolio investment is assumed 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.

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

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

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

The fair value of our CLO bonds and preferred shares/income notes and CDO bonds (CLO/CDO Assets) is generally based on a discounted cash flow model that utilizes prepayment, re-investment and loss assumptions based on historical experience and projected performance, economic factors, the characteristics of the underlying cash flow, and comparable yields for similar bonds and preferred shares/income notes, when available. We recognize unrealized appreciation or depreciation on our 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 or loss assumptions in the underlying collateral pool. We determine the fair value of our CLO/CDO Assets on an individual security-by-security basis.

We will record unrealized depreciation on investments when we determine that the fair value of a security is less than its cost basis, and will record unrealized appreciation when we determine that the fair value is greater than its cost basis.

The impact on our consolidated financial statements for periods subsequent to the period of adoption cannot be determined at this time as it will be influenced by the estimates of fair value for those periods, the number and amount of investments we originate, acquire or exit, and the effect of any additional guidance or any changes in the interpretation of this statement.

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

Net Realized Gains or Losses and Net Change in Unrealized Appreciation or Depreciation. Realized gains or losses are measured by the difference between the net proceeds from the repayment or sale and the cost basis of the investment without regard to unrealized appreciation or depreciation previously recognized, and include investments charged off during the year, 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 and depreciation on accrued interest and dividends receivable and other assets where collection is doubtful.

Interest and Dividend Income. Interest income is recorded on an accrual basis to the extent that such amounts are expected to be collected. For loans and debt securities with contractual payment-in-kind interest, which represents contractual interest accrued and added to the loan balance that generally becomes due at maturity, we will not accrue payment-in-kind interest if the portfolio company valuation indicates that the payment-in-kind interest is not collectible. In general, interest is not accrued on loans and debt securities if we have doubt about interest collection or where the enterprise value of the portfolio company may not support further accrual.

When we receive nominal cost warrants or free equity securities (nominal cost equity), we allocate our cost basis in our investment between debt securities and nominal cost equity at the time of origination. At that time, the original issue discount basis of the nominal cost equity is recorded by increasing the cost basis in the equity and decreasing the cost basis in the related debt securities. Loans in workout status do not accrue interest. In addition, interest may not accrue on loans or debt securities to portfolio companies that are more than 50% owned by us depending on such company s capital requirements. Loan origination fees, original issue discount, and market discount are capitalized and then amortized into interest income using a method that approximates the effective interest method. Upon the prepayment of a loan or debt security, any unamortized loan origination fees are recorded as interest income and any unamortized original issue discount or market discount is recorded as a realized gain.

We recognize interest income on the CLO preferred shares/income notes using the effective interest method, based on the anticipated yield that is determined using the estimated cash flows over the projected life of the investment. Yields are revised when there are changes in actual or estimated cash flows due to changes in prepayments and/or re-investments, credit losses 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.

Fee Income. Fee income includes fees for loan prepayment premiums, guarantees, commitments, and services rendered by us to portfolio companies and other third parties such as diligence, structuring, transaction services, management and consulting services, and other services. Loan prepayment premiums are recognized at the time of prepayment. Guaranty and commitment fees are generally recognized as income over the related period of the guaranty or commitment, respectively. Diligence, structuring, and transaction services fees are generally recognized as income when services are rendered or when the related transactions are completed. Management, consulting and other services fees, including fund management fees, are generally recognized as income as the services are rendered. Fees are not accrued if the Company has doubt about collection of those fees.

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

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

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

Recent Accounting Pronouncements. In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements.* This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We have adopted this statement on a prospective basis beginning in the quarter ended March 31, 2008. Adoption of this statement did not have a material effect on our consolidated financial statements for the period ended March 31, 2008. However, the impact on our consolidated financial statements for periods subsequent to the period of adoption cannot be determined at this time as it will be influenced by the estimates of fair value for those periods, the number and amount of investments we originate, acquire or exit, and the effect of any additional guidance or any changes in the interpretation of this statement.

QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

Our business activities contain elements of risk. We consider the principal types of market risk to be fluctuations in interest rates. We consider the management of risk essential to conducting our businesses. Accordingly, our risk management systems and procedures are designed to identify and analyze our risks, to set appropriate policies and limits and to continually monitor these risks and limits by means of reliable administrative and information systems and other policies and programs.

Because we borrow money to make investments, our net investment income is dependent upon the difference between the rate at which we borrow funds and the rate at which we invest these funds. As a result, there can be no assurance that a significant change in market interest rates will not have a material adverse effect on our net investment income. In periods of rising interest rates, our cost of funds would increase, which would reduce our net investment income. We use a combination of long-term and short-term borrowings and equity capital to finance our investing activities. We utilize our revolving line of credit as a means to bridge to long-term financing. Our long-term fixed-rate investments are financed primarily with long-term fixed-rate debt and equity. We may use interest rate risk management techniques in an effort to limit our exposure to interest rate fluctuations. Such techniques may include various interest rate hedging activities to the extent permitted by the 1940 Act. We have analyzed the potential impact of changes in interest rates on interest income net of interest expense.

Assuming that the balance sheet as of March 31, 2008, were to remain constant and no actions were taken to alter the existing interest rate sensitivity, a hypothetical immediate 1% change in interest rates would have affected net income by approximately 1% over a one year horizon. Although management believes that this measure is indicative of our sensitivity to interest rate changes, it does not adjust for potential changes in credit quality, size and composition of the assets on the balance sheet and other business developments that could affect net increase in net assets resulting from operations, or net income. Accordingly, no assurances can be given that actual results would not differ materially from the potential outcome simulated by this estimate.

In addition, we may have risk regarding portfolio valuation. See Business Portfolio Valuation above.

SENIOR SECURITIES

Information about our senior securities is shown in the following tables as of December 31 for the years indicated in the table, unless otherwise noted. The report of our independent registered public accounting firm on the senior securities table as of December 31, 2007, is attached as an exhibit to the registration statement of which this prospectus is a part. The indicates information which the SEC expressly does not require to be disclosed for certain types of senior securities.

Class and Year	Total Amount Outstanding Exclusive of Treasury Securities[1]	Asset Coverage Per Unit[2]	Involuntary Liquidating Preference Per Unit[3]	Average Market Value Per Unit[4]
Privately Issued Unsecured Notes Payable				
1998	$ 180,000,000	$ 2,734	$	N/A
1999	419,000,000	2,283		N/A
2000	544,000,000	2,445		N/A
2001	694,000,000	2,453		N/A
2002	694,000,000	2,704		N/A
2003	854,000,000	3,219		N/A
2004	981,368,000	2,801		N/A
2005	1,164,540,000	3,086		N/A
2006[5]	1,041,400,000	2,496		N/A
2007[5]	1,042,200,000	2,211		N/A
March 31, 2008 (unaudited)[8]	1,042,800,000	2,291		N/A
Publicly Issued Unsecured Notes Payable				
1998	$ 0	$ 0	$	N/A
1999	0	0		N/A
2000	0	0		N/A
2001	0	0		N/A
2002	0	0		N/A
2003	0	0		N/A
2004	0	0		N/A
2005	0	0		N/A
2006[5]	650,000,000	2,496		$ 1,000
2007[5]	880,000,000	2,211		$ 745
March 31, 2008 (unaudited)[8]	880,000,000	2,291		$ 745
Revolving Lines of Credit				
1998	$ 95,000,000	$ 2,734	$	N/A
1999	82,000,000	2,283		N/A
2000	82,000,000	2,445		N/A
2001	144,750,000	2,453		N/A
2002	204,250,000	2,704		N/A
2003	0	0		N/A
2004	112,000,000	2,801		N/A
2005	91,750,000	3,086		N/A

2006	207,750,000	2,496	N/A
2007	367,250,000	2,211	N/A
March 31, 2008 (unaudited)[8]	268,750,000	2,291	N/A
Small Business Administration Debentures[6]			
1998	$ 47,650,000	$ 2,734	$ N/A
1999	62,650,000	2,283	N/A
2000	78,350,000	2,445	N/A
2001	94,500,000	2,453	N/A
2002	94,500,000	2,704	N/A
2003	94,500,000	3,219	N/A
2004	77,500,000	2,801	N/A
2005	28,500,000	3,086	N/A
2006	0	0	N/A
2007	0	0	N/A
March 31, 2008 (unaudited)	0	0	N/A

Class and Year	Total Amount Outstanding Exclusive of Treasury Securities(1)	Asset Coverage Per Unit(2)	Involuntary Liquidating Preference Per Unit(3)	Average Market Value Per Unit(4)
Overseas Private Investment Corporation Loan				
1998	$ 5,700,000	$ 2,734	$	N/A
1999	5,700,000	2,283		N/A
2000	5,700,000	2,445		N/A
2001	5,700,000	2,453		N/A
2002	5,700,000	2,704		N/A
2003	5,700,000	3,219		N/A
2004	5,700,000	2,801		N/A
2005	0	0		N/A
2006	0	0		N/A
2007	0	0		N/A
March 31, 2008 (unaudited)	0	0		N/A
Auction Rate Reset Note				
1998	$ 0	$ 0	$	N/A
1999	0	0		N/A
2000	76,598,000	2,445		N/A
2001	81,856,000	2,453		N/A
2002	0	0		N/A
2003	0	0		N/A
2004	0	0		N/A
2005	0	0		N/A
2006	0	0		N/A
2007	0	0		N/A
March 31, 2008 (unaudited)	0	0		N/A
Master Repurchase Agreement and Master Loan and Security Agreement				
1998	$ 6,000,000	$ 2,734	$	N/A
1999	23,500,000	2,283		N/A
2000	0	0		N/A
2001	0	0		N/A
2002	0	0		N/A
2003	0	0		N/A
2004	0	0		N/A
2005	0	0		N/A
2006	0	0		N/A
2007	0	0		N/A

March 31, 2008 (unaudited)		0		0			N/A
Redeemable Cumulative Preferred Stock[(6)(7)]							
1998	$	1,000,000	$	267	$	100	N/A
1999		1,000,000		225		100	N/A
2000		1,000,000		242		100	N/A
2001		1,000,000		244		100	N/A
2002		1,000,000		268		100	N/A
2003		1,000,000		319		100	N/A
2004		0		0			N/A
2005		0		0			N/A
2006		0		0			N/A
2007		0		0			N/A
March 31, 2008 (unaudited)		0		0			N/A

Class and Year	Total Amount Outstanding Exclusive of Treasury Securities[1]	Asset Coverage Per Unit[2]	Involuntary Liquidating Preference Per Unit[3]	Average Market Value Per Unit[4]
Non-Redeemable Cumulative Preferred Stock[6]				
1998	$ 6,000,000	$ 267	$ 100	N/A
1999	6,000,000	225	100	N/A
2000	6,000,000	242	100	N/A
2001	6,000,000	244	100	N/A
2002	6,000,000	268	100	N/A
2003	6,000,000	319	100	N/A
2004	0	0		N/A
2005	0	0		N/A
2006	0	0		N/A
2007	0	0		N/A
March 31, 2008 (unaudited)	0	0		N/A

(1) Total amount of each class of senior securities outstanding at the end of the period presented.

(2) The asset coverage ratio for a class of senior securities representing indebtedness is calculated as our consolidated total assets, less all liabilities and indebtedness not represented by senior securities, divided by senior securities representing indebtedness. This asset coverage ratio is multiplied by $1,000 to determine the Asset Coverage Per Unit. The asset coverage ratio for a class of senior securities that is preferred stock is calculated as our consolidated total assets, less all liabilities and indebtedness not represented by senior securities, divided by senior securities representing indebtedness, plus the involuntary liquidation preference of the preferred stock (see footnote 3). The Asset Coverage Per Unit for preferred stock is expressed in terms of dollar amounts per share.

(3) The amount to which such class of senior security would be entitled upon the involuntary liquidation of the issuer in preference to any security junior to it.

(4) Not applicable, except for publicly issued unsecured notes payable, as other senior securities are not registered for public trading. The average market value of the publicly issued unsecured notes payable is calculated as the weighted average face value of the notes. On May 6, 2008, the closing price of our $230 million 6.875% Notes due 2047 was $17.50 per share.

(5) See Note 4 to our December 31, 2007, consolidated financial statements for a description of the terms.

(6) Issued by our small business investment company subsidiary to the Small Business Administration. These categories of senior securities were not subject to the asset coverage requirements of the 1940 Act. During 2006, our small business investment company (SBIC) subsidiary surrendered its SBIC license and was merged into its parent.

(7) The Redeemable Cumulative Preferred Stock was reclassified to Other Liabilities on the accompanying financial statements during 2003 in accordance with SFAS No. 150.

(8) See Note 4 to our March 31, 2008, Consolidated Financial Statements for a description of the terms.

BUSINESS

General

We are a business development company, or BDC, in the private equity business and we are internally managed. Specifically, we provide long-term debt and equity capital to primarily private middle market companies in a variety of industries. We believe the private equity capital markets are important to the growth of small and middle market companies because such companies often have difficulty accessing the public debt and equity capital markets. We believe that we are well positioned to be a source of capital for such companies. We provide our investors the opportunity to participate in the U.S. private equity industry through an investment in our publicly traded stock.

We have participated in the private equity business since we were founded in 1958. Since then through March 31, 2008, we have invested more than $13 billion in thousands of companies nationwide. We primarily invest in the American entrepreneurial economy, helping to build middle market businesses and support American jobs. We generally invest in established companies with adequate cash flow for debt service and that are well positioned for growth. We are not venture capitalists, and we generally do not provide seed, or early stage, capital. At March 31, 2008, our private finance portfolio included investments in 124 companies that generate aggregate annual revenues of over $13 billion and employ more than 98,000 people.

Our investment objective is to achieve current income and capital gains. In order to achieve this objective, we primarily invest in debt and equity securities of private companies in a variety of industries. However, from time to time, we may invest in companies that are public but lack access to additional public capital.

We have also participated in commercial real estate finance over our history. Over the past few years, we have not actively participated in commercial real estate finance as we believed that the market for commercial real estate had become too aggressive and that investment opportunities were not priced appropriately. As a result, our commercial real estate finance portfolio totaled $115.8 million at value, or 2.3% of our total assets, at March 31, 2008. As the capital markets evolve and should commercial real estate investment opportunities improve, we may become more active investors in commercial real estate finance for our own portfolio or through a future managed fund. See Managed Funds below.

In addition to managing our own assets, we manage certain funds that also invest in the debt and equity securities of primarily private middle market companies in a variety of industries. We may invest in the equity of these funds, along with other third parties, from which we may earn a current return and/or a future incentive allocation. We may also manage the assets held by these funds, for which we may earn management or other fees for our services. See Managed Funds below.

We are internally managed, led by an experienced management team with our senior officers and managing directors possessing, on average, 22 years of experience. At March 31, 2008, we had 186 employees, who are focused on transaction sourcing, origination and execution, portfolio monitoring, accounting, valuation and other operational and administrative activities. We are headquartered in Washington, DC, with offices in New York, NY, Chicago, IL, and Los Angeles, CA and have centralized investment approval and portfolio management processes.

Private Equity Investing

As a private equity investor, we spend significant time and effort identifying, structuring, performing due diligence, monitoring, developing, valuing, and ultimately exiting our investments. We generally target companies in less cyclical industries with, among other things, high returns on invested capital, management teams with meaningful equity ownership, well-capitalized balance sheets, and the ability to generate free cash flow. Each investment is subject to an extensive due diligence process. It is not uncommon for a single investment to take from two months to a full year to complete, depending on the complexity of the transaction.

Our investment activity is primarily focused on making long-term investments in the debt and equity of primarily private middle market companies. These investments are generally long-term in nature and privately negotiated, and no readily available market exists for them. This makes our investments highly illiquid and, as a result, we cannot readily trade them. When we make an investment, we enter into a long-term arrangement where our ultimate exit from that investment may be three to ten years in the future.

We believe illiquid investments generally provide better investment returns on average over time than do more liquid investments, such as public equities and public debt instruments, because generally increased returns are associated with the liquidity risk in holding such investments. Investors in illiquid investments cannot manage risk through investment trading techniques. In order to manage our risk, we focus on careful investment selection, thorough due diligence, portfolio monitoring and portfolio diversification. Our investment management processes have been designed to incorporate these disciplines.

We have focused on investments in the debt and equity of primarily private middle market companies because they can be structured to provide recurring cash flow to us as the investor. In addition to earning interest income, we may earn income from management, consulting, diligence, structuring or other fees. We may also enhance our total return with capital gains realized from investments in equity instruments or from equity features, such as nominal cost warrants. For the years 1998 through 2007, we have realized $1.4 billion in cumulative net realized gains from our investment portfolio. Net realized gains for this period as a percentage of total assets are shown in the chart below.

One measure of the performance of a private equity investor is the internal rate of return generated by the investor s portfolio. Since our merger on December 31, 1997, through March 31, 2008, our combined aggregate cash flow internal rate of return, or IRR, has been approximately 21% for private finance and real estate-related CMBS/CDO investments exited during this period. The IRR is calculated using the aggregate portfolio cash flow for all investments exited over this period. For investments exited during this period, we invested capital totaling $4.7 billion. The weighted average holding period of these investments was 39 months. Investments are considered to be exited when the original investment objective has been achieved through the receipt of cash and/or non-cash consideration upon the repayment of our debt

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investment or sale of an equity investment, or through the determination that no further consideration was collectible and, thus, a loss may have been realized. The aggregate cash flow IRR for private finance investments was approximately 20% and for CMBS/CDO investments was approximately 24% for the same period. The weighted average holding period of the private finance and CMBS/CDO investments was 49 months and 22 months, respectively, for the same period. These IRR results represent historical results. Historical results are not necessarily indicative of future results.

We believe our business model is well suited for long-term investing in illiquid assets. Our balance sheet is capitalized with significant equity capital and we use only a modest level of debt capital, which allows us the ability to be patient and to manage through difficult market conditions with less risk of liquidity issues. Under the Investment Company Act of 1940 (the 1940 Act), we are restricted to a debt to equity ratio of approximately one-to-one. Thus, our capital structure, which includes a modest level of long-term leverage, is well suited for long-term illiquid investments.

In general, we compete for investments with a large number of private equity funds and mezzanine funds, other business development companies, hedge funds, investment banks, other equity and non-equity based investment funds, and other sources of financing, including specialty finance companies and traditional financial services companies such as commercial banks. However, we primarily compete with other providers of long-term debt and equity capital to middle market companies, including private equity funds and other business development companies.

Private Finance Portfolio. Our private finance portfolio is primarily composed of debt and equity investments. We generally invest in private companies though, from time to time, we may invest in companies that are public but lack access to additional public capital. These investments are also generally illiquid.

Our capital is generally used to fund:

Buyouts	Recapitalizations
Acquisitions	Note purchases
Growth	Other types of financings

When assessing a prospective private finance investment, we generally look for companies in less cyclical industries in the middle market (i.e., generally $50 million to $500 million in revenues) with certain target characteristics, which may or may not be present in the companies in which we invest. Our target investments generally are in companies with the following characteristics:

Management team with meaningful equity ownership

Dominant or defensible market position

High return on invested capital

Stable operating margins

Ability to generate free cash flow

Well-capitalized balance sheet

We generally target investments in companies in the following industries:

Business Services	Financial Services
Consumer Products	Consumer Services
Industrial Products	Retail

We intend to take a balanced approach to private equity investing that emphasizes a complementary mix of debt investments and buyout investments. The combination of these two types of investments provides current interest and related portfolio income and the potential for future capital gains. Our strategy is to manage risk in these investments through the structure and terms of our debt and equity investments. It is our preference to structure our investments with a focus on current recurring interest and other income, which may include management, consulting or other fees. We generally target debt investments of $10 million to $150 million and buyout investments of up to $300 million of invested capital.

Debt investments may include senior loans, unitranche debt (an instrument that combines both senior and subordinated financing, generally in a first lien position), or subordinated debt (with or without equity features). The junior debt that we invest in that is lower in repayment priority than senior debt is also known as mezzanine debt. We may make equity investments for a minority equity stake in portfolio companies or may receive equity features, such as nominal cost warrants, in conjunction with our debt investments.

Senior loans may carry a fixed rate of interest or a floating rate of interest, usually set as a spread over 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 us monthly or quarterly. Unitranche debt generally carries a fixed rate of interest. Unitranche debt 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 is generally paid to us 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 is generally paid to us quarterly.

We may underwrite or arrange senior loans related to our portfolio investments or for other companies that are not in our portfolio. When we underwrite or arrange senior loans, we may earn a fee for such activities. Senior loans underwritten or arranged by us may or may not be funded by us at closing. When these senior loans are closed, we may fund all or a portion of the underwritten commitment pending sale of the loan to other investors, which may include loan sales to Callidus Capital Corporation (Callidus), a portfolio company controlled by us, or funds managed by Callidus or by us, including the Allied Capital Senior Debt Fund, L.P. or Knightsbridge CLO 2007-1 Ltd. After completion of the loan sales, we may or may not retain a position in these senior loans. We generally earn a fee on the senior loans we underwrite or arrange whether or not we fund the underwritten commitment. In addition, we may fund most or all of the debt and equity capital upon the closing of certain buyout transactions, which may include investments in lower-yielding senior debt. Subsequent to the closing, the portfolio company may refinance all or a portion of the lower-yielding senior debt, which would reduce our investment. Principal collections include repayments of senior debt funded by us that was subsequently sold by us or refinanced or repaid by the portfolio companies.

We may also invest in the bonds or preferred shares/income notes of collateralized loan obligations (CLOs) or collateralized debt obligations (CDOs), where the underlying collateral pool consists of senior loans. Certain of the CLOs and CDOs in which we invest may be managed by Callidus Capital Management, a subsidiary of Callidus, or by us. The CLOs and CDOs in which we invest are invested primarily in first lien loans to corporate borrowers. We are not an investor in CLOs and CDOs that hold subprime residential real estate loans.

In a buyout transaction, we generally invest in senior debt, subordinated debt and equity (preferred and/or voting or non-voting common) where our equity ownership represents a significant portion of the equity, but may or may not represent a controlling interest. If we invest in non-voting equity in a buyout investment, we generally have an option to acquire a controlling stake in the voting securities of the portfolio company at fair market value. We generally structure our buyout investments such that we seek to earn a blended current return on our total capital invested of approximately 10% through a combination of interest income on our loans and debt securities, dividends on our preferred and common equity, and management, consulting, or transaction services fees to compensate us for the managerial assistance that we may provide to the portfolio company. As a result of our significant equity investment in a buyout investment there is potential to realize larger capital gains through buyout investing as compared to debt or mezzanine investing.

The structure of each debt and equity security is specifically negotiated to enable us to protect our investment, with a focus on preservation of capital, and maximize our returns. We include many terms governing interest rate, repayment terms, prepayment penalties, financial covenants, operating covenants, ownership parameters, dilution parameters, liquidation preferences, voting rights, and put or call rights. Our senior loans and unitranche debt are generally in a first lien position, however in a liquidation scenario, the collateral, if any, may not be sufficient to support our outstanding investment. Our junior or mezzanine loans are generally unsecured. Our investments may be subject to certain restrictions on resale and generally have no established trading market.

At March 31, 2008, 80.6% of the private finance portfolio at value consisted of interest bearing securities and 19.4% consisted of equity securities. At March 31, 2008, 85% of our private finance loans and debt securities carried a fixed rate of interest and 15% carried a floating rate of interest. The mix of fixed and variable rate loans and debt securities in the portfolio may vary depending on the level of floating rate senior loans or unitranche debt in the portfolio at a given time. The weighted average yield on our private finance loans and debt securities was 12.2% at March 31, 2008.

At March 31, 2008, 25.7% of the private finance investments at value were in companies more than 25% owned, 8.4% were in companies 5% to 25% owned, and 65.9% were in companies less than 5% owned.

Our ten largest investments at value at March 31, 2008, were as follows:

($ in millions) Portfolio Company	Company Information	At March 31, 2008 Cost	Unrealized Appreciation (Depreciation)	Value	Percentage of Total Assets
EarthColor, Inc.	Commercial printer focused on providing a one-stop printing solution of electronic pre-press, printing and finishing primarily for promotional products such as direct mail pieces, brochures, product information and free standing inserts.	$ 180.7	$ 3.0	$ 183.7	3.6%
Advantage Sales & Marketing, Inc.	Sales and marketing agency providing outsourced sales, merchandising, and marketing services to the consumer packaged goods industry.	$ 155.7	$ 11.9	$ 167.6	3.3%
BenefitMall, Inc.	Insurance general agency providing brokers with products, tools, and services that make selling employee benefits to small businesses more efficient.	$ 115.3	$ 42.9	$ 158.2	3.1%
WMA Equity Corporation and Affiliates d/b/a/ Wear Me Apparel	Designer and marketer of licensed and private children s apparel.	$ 175.3	$ (36.8)	$ 138.5	2.7%
Driven Brands, Inc.	Business format franchisor in the car care sector of the automotive aftermarket industry and in the general car care services with approximately 1,100 locations worldwide operating primarily under the Meineke Car Care Centers ® and Econo Lube N Tune® brands.	$ 149.3	$ (20.4)	$ 128.9	2.5%
Norwesco, Inc.	Designs, manufactures and markets a broad assortment of polyethylene tanks primarily to the agricultural and septic tank markets.	$ 65.2	$ 61.2	$ 126.4	2.5%
Financial Pacific Company	Specialized commercial finance company that leases business-essential equipment to small businesses nationwide.	$ 89.5	$ 20.0	$ 109.5	2.2%

The Step2 Company, LLC	Manufacturer of branded plastic children s and home products manufactured through a rotational molding process.	$ 97.6	$ 1.3	$ 98.9	2.0%
Huddle House, Inc.	Franchisor of value-priced, full service family dining restaurants primarily in the Southeast.	$ 91.5	$ 1.0	$ 92.5	1.8%
Cook Inlet Alternative Risk, LLC	Provider of fee-based management services for self-insured groups.	$ 90.1	$ 1.6	$ 91.7	1.8%

We monitor the portfolio to maintain diversity within the industries in which we invest. We may or may not concentrate in any industry or group of industries in the future. The industry composition of the private finance portfolio at value at March 31, 2008, and December 31, 2007, was as follows:

	2008	2007
Industry		
Business services	36%	37%
Consumer products	25	25
Industrial products	8	10
Financial services	5	6
CLO/ CDO[1]	6	6
Retail	5	4
Consumer services	5	4
Healthcare services	3	3
Asset management	2	1
Other	5	4
Total	100%	100%

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

Commercial Real Estate Finance Portfolio. Since 1998, our commercial real estate investments were generally in the non-investment grade tranches of commercial mortgage-backed securities, also known as CMBS, and in the bonds and preferred shares of collateralized debt obligations, also known as CDOs. On May 3, 2005, we completed the sale of our portfolio of CMBS and CDO investments to affiliates of Caisse de dépôt et placement du Québec (the Caisse). See Management s Discussion and Analysis of Financial Condition and Results of Operations. Simultaneous with the sale of our CMBS and CDO portfolio, we entered into a platform assets purchase agreement, under which we have agreed not to primarily invest in non-investment grade CMBS and real estate related CDOs and refrain from certain other real estate related investing or servicing activities for a period of three years or through May 2008 subject to certain limitations and excluding our existing portfolio and related activities.

At March 31, 2008, our commercial real estate finance portfolio consisted of commercial mortgage loans, real estate owned and equity interests, which totaled $115.8 million at value, or 2.3% of our total assets.

Managed Funds

We manage funds that invest in the debt and equity of primarily private middle market companies in a variety of industries (together, the Managed Funds). As of March 31, 2008, the funds that we manage had total assets of approximately $1.2 billion. During 2007, we established the Allied Capital Senior Debt Fund, L.P. and the Unitranche Fund LLC, and in the first quarter of 2008, we formed the AGILE Fund I, LLC and assumed the management of Knightsbridge CLO 2007-1 Ltd., all discussed below. Our responsibilities to the Managed Funds may include deal origination, underwriting, and portfolio monitoring and development services consistent with the activities that we perform for our portfolio as outlined below. Each of the Managed Funds may separately invest in the debt or equity of a portfolio company. Our portfolio may include debt or equity investments issued by the same portfolio company as investments held by one or more Managed Funds, and these investments may be senior, pari passu or junior to the debt and equity investments held by us. We may or may not participate in investments made by investment funds managed by us or one of our affiliates. We expect to continue to grow our managed capital base and have identified other private equity-related funds that we intend to develop. By growing our privately managed capital base, we are seeking to diversify our sources of capital, leverage our core investment expertise and increase fees and other income from asset management activities. See Risk Factors There are potential conflicts of interest between us and the funds managed by us.

Allied Capital Senior Debt Fund, L.P. The Allied Capital Senior Debt Fund, L.P. (ACSDF) is a private fund that generally invests in senior, unitranche and second lien debt. ACSDF has closed on $125 million in equity capital commitments and had total assets of approximately $432 million at March 31, 2008. A.C. Corporation (AC Corp), our wholly-owned subsidiary, is the investment manager and Callidus acts as special manager to ACSDF. One of our affiliates is the general partner of ACSDF, and AC Corp serves as collateral manager to a warehouse financing vehicle associated with ACSDF. AC Corp will earn a management fee of up to 2% per annum of the net asset value of ACSDF and will pay Callidus 25% of that management fee to compensate Callidus for its role as special manager.

We are a special limited partner in ACSDF, which is a portfolio investment, and have committed and funded $31.8 million to ACSDF. At March 31, 2008, our investment in ACSDF totaled $31.8 million at cost and $32.6 million at value. As a special limited partner, we expect to earn an incentive allocation of 20% of ACSDF s annual net income earned in excess of a specified minimum return, subject to certain performance benchmarks.

From time to time, we may offer to sell loans to ACSDF or the warehouse financing vehicle. ACSDF or the warehouse financing vehicle may purchase loans from us. They also purchase loans from other third parties.

Unitranche Fund LLC. In December 2007, we formed the Unitranche Fund LLC (Unitranche Fund), which we co-manage with an affiliate of General Electric Capital Corporation (GE). The Unitranche Fund is a private fund that generally focuses on making first lien unitranche loans to middle market companies with Earning Before Interest, Taxes, Depreciation, and Amortization (EBITDA) of at least $15 million. The Unitranche Fund may invest up to $270 million in a single borrower. For financing needs greater than $270 million, we and GE may jointly underwrite additional financing for a total unitranche financing of up to $500 million. Allied Capital, GE and the Unitranche Fund may co-invest in a single borrower, with the Unitranche Fund holding at least a majority of the issuance. We may hold the portion of a unitranche loan underwritten by us. GE has committed $3.075 billion to the Unitranche Fund consisting of $3.0 billion of senior notes and $0.075 billion of subordinated certificates and we have committed $525.0 million of subordinated certificates. The Unitranche Fund will be capitalized as transactions are completed. At March 31, 2008, our investment in the Unitranche Fund totaled $31.5 million at cost and at value.

The Unitranche Fund is governed by an investment committee with equal representation from Allied Capital and GE and both Allied Capital and GE and its affiliates provide origination, underwriting and portfolio management services to the Unitranche Fund. We will earn a management and sourcing fee totaling 0.375% per annum of managed assets.

AGILE Fund I, LLC. In January 2008, we entered into an investment agreement with the Goldman Sachs Private Equity Group, part of Goldman Sachs Asset Management (Goldman Sachs). As part of the investment agreement, we agreed to sell a pro-rata strip of private equity and debt investments to AGILE Fund I, LLC (AGILE), a private fund in which a fund managed by Goldman Sachs owns substantially all of the interests, for a total transaction value of $167 million. The sales of the assets closed in first quarter of 2008.

The sale to AGILE included 13.7% of our equity investments in 23 of our buyout portfolio companies and 36 of our minority equity portfolio companies for a total purchase price of $104 million, which resulted in a net realized gain of $8.8 million and dividend income of $5.4 million. In addition, we sold approximately $63 million in debt investments, which represented 7.3% of our unitranche, second lien and subordinated debt investments in the buyout investments included in the equity sale. AGILE generally has the right to co-invest in its proportional share of any future follow-on investment opportunities presented by the companies in its portfolio.

We are the managing member of AGILE, and will be entitled to an incentive allocation subject to certain performance benchmarks. We own the remaining interests in AGILE not held by Goldman Sachs. At March 31, 2008, AGILE has total assets of approximately $174 million and our investment in AGILE totaled $0.9 million at cost and at value.

In addition, pursuant to the investment agreement Goldman Sachs has committed to invest at least $125 million in future investment vehicles managed by us and will have future opportunities to invest in our affiliates, or vehicles managed by them, and to co-invest alongside us in the future, subject to various terms and conditions.

As part of this transaction, we sold nine venture capital and private equity limited partnership investments for approximately $28 million to a fund managed by Goldman Sachs, which will assume the $4.7 million of unfunded commitments related to these limited partnership investments. The sales of these limited partnership investments closed at the end of the first quarter of 2008, and resulted in a net realized loss of $5.5 million.

Knightsbridge CLO 2007-1 Ltd. On March 31, 2008, we assumed the management of Knightsbridge CLO 2007-1 Ltd. We earn a management fee of up to 0.6% per annum of the assets of the fund. Callidus may assist us in the management of the fund and we may pay Callidus a portion of the management fee earned for this assistance. This CLO invests primarily in middle market senior loans. At March 31, 2008, Knightsbridge CLO 2007-1 Ltd. had total assets of approximately $500 million and our investment in this CLO totaled $54.4 million at cost and $53.0 million at value.

In aggregate, including the total assets on our balance sheet and capital committed to our Managed Funds, we have more than $9 billion in managed capital.

Business Processes

Business Development and New Deal Origination. Over the years, we believe we have developed and maintained a strong industry reputation and an extensive network of relationships. We have business development professionals dedicated to sourcing investments through our relationships with numerous private equity investors, investment banks, business brokers, merger and acquisition advisors, financial services companies, banks, law firms and accountants through whom we source investment opportunities. Through these relationships, we believe we have been able to strengthen our position as a private equity investor. We are well known in the private equity industry, and we believe that our experience and reputation provide a competitive advantage in originating new investments.

We believe that our debt portfolio relationships and sponsor relationships are a significant source for buyout investments. We generally source our buyout transactions in ways other than going to broad auctions, which include capitalizing on existing relationships with companies and sponsors to participate in proprietary buyout opportunities. We work closely with these companies and sponsors while we are debt investors so that we may be positioned to partner with them on buyout opportunities in a subsequent transaction.

From time to time, we may receive referrals for new prospective investments from our portfolio companies as well as other participants in the capital markets. We may pay referral fees to those who refer transactions to us that we consummate.

New Deal Underwriting and Investment Execution. In a typical transaction, we review, analyze, and substantiate through due diligence, the business plan and operations of the potential portfolio company. We perform financial due diligence, perform operational due diligence, study the industry and competitive landscape, and conduct reference checks with company management or other employees, customers, suppliers, and competitors, as necessary. We may work with external consultants, including accounting firms and industry or operational consultants, in performing due diligence and in monitoring our portfolio investments.

Once we have determined that a prospective portfolio company is suitable for investment, we work with the management and the other capital providers, including senior, junior, and equity capital providers, to structure a deal. We negotiate among these parties to agree on the rights and terms of our investment relative to the other capital in the portfolio company s capital structure. The typical debt transaction requires approximately two to six months of diligence and structuring before funding occurs. The typical buyout transaction may take longer to complete because the due diligence and structuring process is significantly longer when investing in a substantial equity stake in the company.

Our investments are tailored to the facts and circumstances of each deal. The specific structure is designed to protect our rights and manage our risk in the transaction. We generally structure the debt instrument to require restrictive affirmative and negative covenants, default penalties, or other protective provisions. In addition, each debt investment is individually priced to achieve a return that reflects our rights and priorities in the portfolio company s capital structure, the structure of the debt instrument, and our perceived risk of the investment. Our loans and debt securities have an annual stated interest rate; however, that interest rate is only one factor in pricing the investment. The annual stated interest rate may include some component of contractual payment-in-kind interest, which represents contractual interest accrued and added to the loan balance that generally becomes due at maturity or upon prepayment. In addition to the interest earned on loans and debt securities, our debt investments may include equity features, such as nominal cost warrants or options to buy a minority interest in the portfolio company. In a buyout transaction where our equity investment represents a significant portion of the equity, our equity ownership may or may not represent a controlling interest. If we invest in non-voting equity in a buyout, we generally have an option to acquire a controlling stake in the voting securities of the portfolio company at fair market value.

We have a centralized, credit-based approval process. The key steps in our investment process are:

- Initial investment screening;
- Initial investment committee approval;
- Due diligence, structuring and negotiation;
- Internal review of diligence results, including peer review;
- Final investment committee approval;
- Approval by the Investment Review Committee of the Board of Directors for all debt investments that represent a commitment equal to or greater than $20 million and every buyout transaction; and
- Funding of the investment (due diligence must be completed with final investment committee approval and Board Investment Review Committee approval, as needed, before funds are disbursed).

The investment process benefits from the significant professional experience of the members of our investment committee, which is chaired by our Chief Executive Officer and includes our Chief Operating Officer, our Chief Financial Officer, and certain of our Managing Directors, two of whom serve as vice chairmen of the investment committee.

Portfolio Monitoring and Development. Middle market companies often lack the management expertise and experience found in larger companies. As a BDC, we are required by the 1940 Act to make available significant managerial assistance to our portfolio companies. Our senior level professionals work with portfolio company management teams to assist them in building their businesses. Managerial assistance includes, but is not limited to, management and consulting services related to corporate finance, marketing, human resources, personnel and board member recruiting, business operations, corporate governance, risk management and other general business matters. Our corporate finance assistance includes supporting our portfolio companies efforts to structure and attract additional capital. We believe our extensive network of industry relationships and our internal resources help make us a collaborative partner in the development of our portfolio companies.

Our team of investment professionals regularly monitors the status and performance of each investment. This portfolio company monitoring process generally includes review of the portfolio company s financial performance against its business plan, review of current financial statements and compliance with financial covenants, evaluation of significant current developments and assessment of future exit strategies. For debt investments we may have board observation rights that allow us to attend portfolio company board meetings. For buyout investments, we generally hold a majority of the seats on the board of directors where we own a controlling interest in the portfolio company and we have board observation rights where we do not own a controlling interest in the portfolio company.

Our portfolio management committee is responsible for review and oversight of the investment portfolio, including reviewing the performance of selected portfolio companies, overseeing portfolio companies in workout status, reviewing and approving certain modifications or amendments to or certain additional investments in existing investments, reviewing and approving certain portfolio exits, reviewing and approving certain actions by portfolio companies whose voting securities are more than 50% owned by us, reviewing significant investment-related litigation matters where we are a named party, and reviewing and approving proxy votes with respect to our portfolio investments. Our portfolio management committee is chaired by our Chief Executive Officer and includes our Chief Operating Officer, Chief Financial Officer, Chief Valuation Officer (non-voting member), our private finance general counsel, and certain of our Managing Directors. From time to time we will identify investments that require closer monitoring or become workout assets. We develop a workout strategy for workout assets and the portfolio management committee gauges our progress against the strategy.

We seek to price our investments to provide an investment return considering the fact that certain investments in the portfolio may underperform or result in loss of investment return or investment principal. As a private equity investor, we will incur losses from our investing activities, however we have a history of working with troubled portfolio companies in order to recover as much of our investments as is practicable.

Portfolio Grading

We employ a grading system for our entire portfolio. Grade 1 is for those investments from which a capital gain is expected. Grade 2 is for investments performing in accordance with plan. Grade 3 is for investments that require closer monitoring; however, no loss of investment return or principal is expected. Grade 4 is for investments that are in workout and for which some loss of current investment return is expected, but no loss of principal is expected. Grade 5 is for investments that are in workout and for which some loss of principal is expected. At March 31, 2008, Grade 1, 2, and 3 investments totaled $4,522.6 million, or 97.6% of the total portfolio at value, and Grade 4 and 5 investments totaled $113.0 million, or 2.4% of the total portfolio at value.

Portfolio Valuation

We determine the value of each investment in our portfolio on a quarterly basis, and changes in value result in unrealized appreciation or depreciation being recognized in our statement of operations. Value, as defined in Section 2(a)(41) of the 1940 Act, is (i) the market price for those securities for which a market quotation is readily available and (ii) for all other securities and assets, fair value is as determined in good faith by the Board of Directors. Since there is typically no readily available market value for the investments in our portfolio, we value substantially all of our portfolio investments at fair value as determined in good faith by the Board of Directors in accordance with our valuation policy and the provisions of the 1940 Act and FASB Statement No. 157, *Fair Value Measurements* (SFAS 157 or the Statement). We determine fair value to be the price that would be received for an investment in a current sale, which assumes an orderly transaction between market participants on the measurement date. At March 31, 2008, portfolio investments recorded at fair value using level 3 inputs (as defined under the Statement) were approximately 91% of our total assets. Because of the inherent uncertainty of determining the fair value of investments that do not have a readily available market value, the fair value of our investments determined in good faith by the Board of Directors may differ significantly from the values that would have been used had a ready market existed for the investments, and the differences could be material. Additionally, changes in the market environment and other events that may occur over the life of our investments may cause the gains or losses ultimately realized on our investments to be different than the values determined at the measurement date.

There is no single approach for determining fair value in good faith. As a result, determining fair value requires that judgment be applied to the specific facts and circumstances of each portfolio investment while employing a consistently applied valuation process for the types of investments we make. Unlike banks, we are not permitted to provide a general reserve for anticipated loan losses. Instead, we are required to specifically value each individual investment on a quarterly basis. We will record unrealized depreciation on investments when we determine that the fair value of a security is less than its cost basis, and we will record unrealized appreciation when we determine that the fair value is greater than its cost basis. Changes in fair value are recorded in the statement of operations as net change in unrealized appreciation or depreciation. See Management s Discussion and Analysis of Financial Condition and Results of Operations Results of Operations Change in Unrealized Appreciation or Depreciation for a discussion of our valuation methodology.

Valuation Process. The portfolio valuation process is managed by our Chief Valuation Officer (CVO). The CVO works with the investment professionals responsible for each investment. The following is an overview of the steps we take each quarter to determine the value of our portfolio.

Our valuation process begins with each portfolio company or investment being initially valued by the investment professionals, led by the Managing Director or senior officer who is responsible for the portfolio company relationship (the Deal Team).

The CVO and third-party valuation consultants, as applicable (see below), review the preliminary valuation documentation as prepared by the Deal Team.

The CVO, members of the valuation team, and third-party consultants (see below), as applicable, meet with each Managing Director or responsible senior officer to discuss the preliminary valuation determined and documented by the Deal Team for each of their respective investments.

The CEO, COO, CFO and the Managing Directors meet with the CVO to discuss the preliminary valuation results.

Valuation documentation is distributed to the members of the Board of Directors.

The Audit Committee of the Board of Directors meets separately from the full Board of Directors with the third-party consultants (see below) to discuss the assistance provided and results. The CVO attends this meeting.

The CVO discusses and reviews the valuations with the Board of Directors.

To the extent there are changes or if additional information is deemed necessary, a follow-up Board meeting may take place.

The Board of Directors determines the fair value of the portfolio in good faith.

In connection with our valuation process to determine the fair value of a private finance investment, we work with third-party consultants to obtain assistance and advice as additional support in the preparation of our internal valuation analysis for a portion of the portfolio each quarter. In addition, we may receive other third-party assessments of a particular private finance portfolio company s value in the ordinary course of business, most often in the context of a prospective sale transaction or in the context of a bankruptcy process.

The valuation analysis prepared by management is submitted to our Board of Directors who is ultimately responsible for the determination of fair value of the portfolio in good faith. Valuation assistance from Duff & Phelps, LLC (Duff & Phelps) for our private finance portfolio consists of certain limited procedures (the Procedures) we have identified and requested them to perform. In addition, we also received third-party valuation assistance from other third-party consultants for certain private finance portfolio companies. See Management s Discussion and Analysis of Financial Condition and Results of Operations above.

We work with third-party consultants to obtain valuation assistance for a portion of the private finance portfolio each quarter. We currently anticipate that we will generally obtain valuation assistance for all companies in the portfolio where we own more than 50% of the outstanding voting equity securities on a quarterly basis and that we will generally obtain assistance for companies where we own equal to or less than 50% of the outstanding voting equity securities at least once during the course of the calendar year. Valuation assistance may or may not be obtained for new companies that enter the portfolio after June 30 of any calendar year during that year or for investments with a cost and value less than $250,000. For the quarter ended March 31, 2008, we received valuation assistance for 124 portfolio companies, which represented 94% of the private finance portfolio at value. See Management s Discussion and Analysis of Financial Condition and Results of Operations above.

Disposition of Investments

We manage our portfolio of investments in an effort to maximize our expected returns. We are generally repaid by our borrowers and exit our debt and equity investments as portfolio companies are sold, recapitalized or complete an initial public offering.

We may retain a position in the senior loans we originate or we may sell all or a portion of these investments. In our debt investments where we have equity features, we are generally in a minority ownership position in a portfolio company, and as a result, generally exit the investment when the majority equity stakeholder decides to sell or recapitalize the company. Where we have a control position in an investment, as we may have in buyout investments, we have more flexibility and can determine whether or not we should exit our investment. Our most common exit strategy for a buyout investment is the sale of a portfolio company to a strategic or financial buyer. If an investment has appreciated in value, we may realize a gain when we exit the investment. If an investment has depreciated in value, we may realize a loss when we exit the investment.

We are in the investment business, which includes acquiring and exiting investments. It is our policy not to comment on potential transactions in the portfolio prior to reaching a definitive agreement or, in many cases, prior to consummating a transaction. To the extent we enter into any material transactions, we would provide disclosure as required.

Dividends

We have elected to be taxed as a regulated investment company under Subchapter M of the Internal Revenue Code of 1986 (the Code). Assuming that we continue to qualify as a regulated investment company, we generally will not be subject to corporate level income taxation on income we timely distribute to our stockholders as dividends. We pay regular quarterly dividends based upon an estimate of annual taxable income available for distribution to shareholders, which includes our taxable interest, dividend, and fee income, as well as taxable net capital gains. Taxable income generally differs from net income for financial reporting purposes due to temporary and permanent differences in the recognition of income and expenses, and generally excludes net unrealized appreciation or depreciation, as gains or losses generally are not included in taxable income until they are realized. In addition, gains realized for financial reporting purposes may differ from gains included in taxable income as a result of our election to recognize gains using installment sale treatment, which generally results in the deferment of gains for tax purposes until notes or other amounts, including amounts held in escrow, received as consideration from the sale of investments are collected in cash. Taxable income includes non-cash income, such as changes in accrued and reinvested interest and dividends, which includes contractual payment-in-kind interest, and the amortization of discounts and fees. Cash collections of income resulting from contractual payment-in-kind interest or the amortization of discounts and fees generally occur upon the repayment of the loans or debt securities that include such items. Non-cash taxable income is reduced by non-cash expenses, such as realized losses and depreciation and amortization expense.

As a regulated investment company, we distribute substantially all of our annual taxable income to shareholders through the payment of cash dividends. Our Board of Directors reviews the dividend rate quarterly, and may adjust the quarterly dividend throughout the year. Dividends are declared considering our estimate of annual taxable income available for distribution to shareholders and the amount of taxable income carried over from the prior year for distribution in the current year. Our goal is to declare what we believe to be sustainable increases in our regular quarterly dividends. To the extent that we earn annual taxable income in excess of dividends paid from such taxable income for the year, we may carry over the excess taxable income into the next year and such excess income will be available for distribution in the next year as permitted under the Code. The maximum amount of excess taxable income that may be carried over for distribution in the next year under the Code is the total amount of dividends paid in the following year, subject to certain declaration and payment guidelines. Excess taxable income carried over and paid out in the next year is generally subject to a nondeductible 4% excise tax. See Management s Discussion and Analysis of Financial Condition and Results of Operation Other Matters Regulated Investment Company Status . We believe that carrying over excess taxable income into future periods may provide increased visibility with respect to taxable earnings available to pay the regular quarterly dividend.

We began paying quarterly dividends in 1963, and our portfolio has provided sufficient ordinary taxable income and realized net capital gains to sustain or grow our dividends over time. Since inception through December 31, 2007, our average annual total return to shareholders (assuming all dividends were reinvested) was 16.9%. Over the past one, three, five and ten years (assuming each period ended on December 31, 2007), our total return to shareholders (assuming all dividends were reinvested) has been (27.6%), 2.5%, 8.9% and 8.8%, respectively, with the dividend providing a meaningful portion of this return.

The percentage of our dividend generated by ordinary taxable income versus capital gain income will vary from year to year. The percentage of ordinary taxable income versus net capital gain income supporting the dividend since 1987 is shown below.

Corporate Structure and Offices

We are a Maryland corporation and a closed-end, non-diversified management investment company that has elected to be regulated as a business development company under the 1940 Act. We have a real estate investment trust subsidiary, Allied Capital REIT, Inc., and several subsidiaries that are single-member limited liability companies established for specific purposes, including holding real estate property. We also have a subsidiary, A.C. Corporation, that generally provides diligence and structuring services, as well as transaction, management, consulting, and other services, including underwriting and arranging senior loans, to Allied Capital and our portfolio companies. A.C. Corporation also provides fund management services to certain funds managed by us.

Our executive offices are located at 1919 Pennsylvania Avenue, NW, Washington, DC 20006-3434 and our telephone number is (202) 721-6100. In addition, we have regional offices in New York, Chicago, and Los Angeles.

Properties

Our principal offices are located at 1919 Pennsylvania Avenue, N.W., Washington, DC 20006-3434. Our lease for approximately 56,000 square feet of office space at that location expires in December 2010. The office is equipped with an integrated network of computers for word processing, financial analysis, accounting and loan servicing. We believe our office space is suitable for our needs for the foreseeable future. We also maintain offices in New York, NY; Chicago, IL; and Los Angeles, CA.

Employees

At March 31, 2008, we employed 186 individuals including investment and portfolio management professionals, operations professionals and administrative staff. The majority of our employees are located in our Washington, DC office. We believe that our relations with our employees are excellent.

Legal Proceedings

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

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

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

On February 13, 2007, Rena Nadoff filed a shareholder derivative action in the Superior Court of the District of Columbia, captioned Rena Nadoff v. Walton, et al., CA 001060-07, seeking unspecified compensatory and other damages, as well as equitable relief on behalf of Allied Capital Corporation. The complaint was summarily dismissed in July 2007. The complaint alleged breach of fiduciary duty by the Board of Directors arising from internal control failures and mismanagement of Business Loan Express, LLC, an Allied Capital portfolio company. On October 5, 2007, Rena Nadoff sent a letter to our Board of Directors with substantially the same claims and a request that the Board of Directors investigate the claims and take appropriate action. The Board of Directors has established a committee, which is advised by its own counsel, to review the matter.

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

In addition to the above matters, we are party to certain lawsuits in the normal course of business.

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

PORTFOLIO COMPANIES

The following is a listing of each portfolio company or its affiliate, together referred to as portfolio companies, in which we had an equity investment at March 31, 2008. Percentages shown for class of securities held by us represent percentage of the class owned and do not necessarily represent voting ownership or economic ownership. Percentages shown for equity securities other than warrants or options represent the actual percentage of the class of security held before dilution. Percentages shown for warrants and options held represent the percentage of class of security we may own assuming we exercise our warrants or options before dilution.

The portfolio companies are presented in three categories: companies more than 25% owned which represent portfolio companies where we directly or indirectly own more than 25% of the outstanding voting securities of such portfolio company and, therefore, are deemed controlled by us under the 1940 Act; companies owned 5% to 25% which represent portfolio companies where we directly or indirectly own 5% to 25% of the outstanding voting securities of such portfolio company or where we hold 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 we directly or indirectly own less than 5% of the outstanding voting securities of such portfolio company and where we have no other affiliations with such portfolio company. We make available significant managerial assistance to our portfolio companies. We generally receive rights to observe the meetings of our portfolio companies board of directors, and may have one or more voting seats on their boards.

For information relating to the amount and nature of our investments in portfolio companies, see our consolidated statement of investments at March 31, 2008, at pages F-76 to F-92.

Name and Address of Portfolio Company	Nature of its Principal Business	Title of Securities Held by the Company	Percentage of Class Held
PRIVATE FINANCE			
Companies More Than 25% Owned			
AGILE Fund I, LLC[1] 1919 Pennsylvania Ave, N.W. Washington, DC 20006	Private Equity Fund	Equity Interests	0.5%
Alaris Consulting, LLC[1][2] 1815 South Meyers Road Suite 1000 Oakbrook, IL 60181	Consulting Firm	Equity Interests	83.1%
AllBridge Financial, LLC[1] 5080 Spectrum Drive Suite 1150 E Addison, TX 75001	Real Estate Finance Company	Class A Equity Interests	95.2%
Allied Capital Senior Debt Fund, L.P. [1][12] 1919 Pennsylvania Ave, N.W. Washington, DC 20006	Private Debt Fund	Class A-1 Limited Partnership Interest	41.0%
Avborne, Inc.[1][7] PO Box 52-2602	Aviation Services	Series B Preferred Stock Common Stock	23.8% 27.2%

Miami, FL 33152			
Avborne Heavy Maintenance, Inc.[1][7] PO Box 52-2602 Miami, FL 33152	Aviation Services	Series A Preferred Stock Common Stock	27.5% 27.5%
Aviation Properties Corporation[1] 1919 Pennsylvania Avenue, N.W. Washington, DC 20006	Aviation Services	Common Stock	100.0%
Border Foods, Inc.[1] 4065 I Street SE Deming, NM 88030	Mexican Ingredient & Food Product Manufacturer	Series A Preferred Stock Series A Common Stock	100.0% 100.0%
Calder Capital Partners, LLC[1] 321 North Clark Street, 8th Floor Chicago, IL 60610	Private Investment Firm	Equity Interests	65.0%
Callidus Capital Corporation[1][4] 520 Madison Avenue New York, NY 10022	Asset Manager and Finance Company	Common stock	100.0%

Name and Address of Portfolio Company	Nature of its Principal Business	Title of Securities Held by the Company	Percentage of Class Held
Ciena Capital LLC[1] 1633 Broadway New York, NY 10019	Real-Estate Secured Lender	Class A Equity Interests Class B Equity Interests Class C Equity Interests Equity Interest in Ciena Subsidiary[3]	100.0% 100.0% 94.9% 20.0%
CitiPostal, Inc.[1] 5 North 11th Street Brooklyn, NY 11211	Document Storage and Management	Common Stock	63.1%
Coverall North America, Inc.[1] 5201 Congress Avenue Suite 275 Boca Raton, FL 33487	Corporate Cleaning Service Provider	Common Stock	85.2%
CR Holding, Inc.[1] 141 Venture Boulevard Spartanburg, SC 29306	Household Cleaning Products	Common Stock	70.9%
Crescent Equity Corp.[11] 1919 Pennsylvania Ave, N.W. Washington, DC 20006	Hotel Management Company and Multi-system Cable Operator	Common Stock	86.3%
Direct Capital Corporation[1] 155 Commerce Way Portsmouth, NH 03801	Business Equipment Leasing	Class A Common Stock	57.3%
Financial Pacific Company[1] 3455 South 344th Way Suite 300 Federal Way, WA 98001	Commercial Finance Leasing	Series A Preferred Stock Common Stock	85.7% 85.8%
ForeSite Towers, LLC [1] 5809 Feldspar Way Birmingham, AL 35244	Tower Leasing	Common Equity Interest	88.1%
Hot Light Brands, Inc. 11780 Manchester Road Suite 207 St. Louis, MO 63131	Retail	Common Stock	100.0%
Hot Stuff Foods, LLC [1]	Foodservice to	Class B Common Stock	95.0%

2930 W. Maple Street Sioux Falls, SD 57118	Convenience Stores	Class A Common Stock	66.1%
Huddle House, Inc.[1] 5901-B Peachtree-Dunwoody Road Suite 450 Atlanta, Georgia 30328	Restaurant Franchisor	Common Stock	84.0%
Impact Innovations Group, LLC 2500 Northwinds Parkway Suite 200 Alpharetta, GA 30004	Information Technology Services Provider	Equity Interests in Affiliate[5]	50.0%
Insight Pharmaceuticals Corporation [1] 1170 Wheeler Way Suite 150 Langhorne, PA 19047	Marketer of Over-The-Counter Pharmaceuticals	Preferred Stock Common Stock	100.0% 99.7%
Legacy Partners Group, Inc.[1] 1919 Pennsylvania Ave, N.W. Washington, DC 20006	Merger and Acquisition Advisor	Equity Interests	100.0%
Litterer Beteiligungs-GmbH 68165 Manheim Germany	Scaffolding Company	Equity Interest	25.0%
MHF Logistical Solutions, Inc.[1][6] 800 Cranberry Woods Drive Suite 450 Cranberry Township, PA 16066	Third-Party Environmental Logistics	Class B Common Stock Series A Preferred Stock Class A Common Stock	58.3% 100.0% 98.9%
MVL Group, Inc.[1] 1061 E. Indiantown Road Suite 300 Jupiter, FL 33477	Market Research Services	Common Stock	55.9%
Old Orchards Brand, LLC[1] 1991 Twelve Mile Road Sparta, MI 49345	Beverage Manufacturer and Marketer	Equity Interests	78.8%

Name and Address of Portfolio Company	Nature of its Principal Business	Title of Securities Held by the Company	Percentage of Class Held
Penn Detroit Diesel Allison, LLC[1] 8330 State Road Philadelphia, PA 19136	Distributor of Engines, Transmissions, and Parts	Equity Interests	78.1%
Service Champ, Inc.[1] 180 New Britain Boulevard Chalfont, PA 18914	Wholesale Distributor of Auto Parts	Common Stock	54.8%
Startec Equity, LLC 1919 Pennsylvania Avenue N.W. Washington, DC 20006	Telecommunications Services	Equity Interests	100.0%
Sweet Traditions, Inc.[1] 11780 Manchester Road Suite 207 St. Louis, MO 63131	Franchisor of Krispy Kreme Doughnut Corporation	Class B-2 Preferred Stock Class A-1 Common Stock	100.0% 51.0%
Unitranche Fund LLC [1] c/o Corporation Service Company 2711 Centerville Road Wilmington, DE 19808	Private Debt Fund	Equity Interests	87.5%
Worldwide Express Operations, LLC[1] 2828 Routh Street Suite 400 Dallas, TX 75201	Reseller of Shipping Services	Equity Interests Warrants to Purchase Equity Interests	53.8% 0.7%
Companies 5% to 25% Owned			
10th Street, LLC 5 North 11th Street Brooklyn, NY 11211	Document Storage	Equity Interests	10.0%
Advantage Sales & Marketing, Inc.[1] 19100 Von Karman Avenue Suite 600 Irvine, CA 92612	Sales and Marketing Agency	Equity Interests	4.2%
Air Medical Group Holdings LLC 306 Davis Drive P.O. Box 768	Air Ambulance Service	Series A Preferred Equity Interests Series B Preferred Equity	6.4%

West Plains, MO 65775		Interests	6.2%
Alpine ESP Holdings, Inc. 3361 Rouse Road Suite 165 Orlando, FL 32817	Engineering and Technical Services	Preferred Stock Common Stock	11.3% 9.3%
Amerex Group, LLC[1] 512 Seventh Avenue New York, NY 10118	Outerwear Apparel Supplier	Class B Equity Interests	100.0%
BB&T Capital Partners/ Windsor Mezzanine Fund, LLC 101 N. Cherry Street Suite 400 Winston-Salem, NC 27101	Private Equity Fund	Class A Equity Interests[14]	32.6%
Becker Underwood, Inc. 801 Dayton Avenue Ames, IA 50010	Speciality Chemical Manufacturer	Common Stock	4.8%
BI Incorporated 6400 Lookout Road Boulder, CO 80301	Electronic Monitoring Equipment	Common Stock	6.1%
Creative Group, Inc.[1] 1601 Broadway, 10th Floor New York, NY 10019	Concept-to-Completion Development	Class B Common Stock Warrants to Purchase Class B Common Stock	100.0% 100.0%
Drew Foam Companies, Inc. 1093 Highway 278 East Monticello, AR 71655	Polystyrene Block Plastic Foam Manufacturer	Preferred Stock Common Stock	7.6% 6.3%
Hilden America, Inc. 1044 Commerce Lane South Boston, VA 24592	Distributor of Luxury Sheets	Common Stock	8.1%
MedBridge Healthcare, LLC[1] 110 West North Street Suite 100 Greenville, SC 29601	Sleep Diagnostic Facilities	Debt Convertible into Equity Interests Class C Equity Interest	 75.0% 100.0%

Name and Address of Portfolio Company	Nature of its Principal Business	Title of Securities Held by the Company	Percentage of Class Held
Multi-Ad Services, Inc. 1720 W. Detweiller Drive Peoria, IL 61615	Marketing Services	Series A Preferred Equity Interests	17.4%
		Class A Common Equity Interests	10.5%
Progressive International Corporation 6111 S. 228th Street Kent, WA 98032	Retail Kitchenware	Series A Redeemable Preferred Stock	14.3%
		Class A Common Stock	1.0%
		Warrants to Purchase Class A Common Stock	42.3%
Regency Healthcare Group, LLC 2151 Highland Avenue Suite 350 Birmingham, AL 35205	Hospice Services	Class A Equity Interests	8.8%
SGT India Private Limited[1] 5858 Westheimer Road Houston, TX 77057	Software/Business Process Developer	Common Stock	21.8%
Soteria Imaging Services, LLC 6009 Brownsboro Park Boulevard Suite H Louisville, KY 40207	Diagnostic Imaging Facilities Operator	Class A Preferred Equity Interests	10.8%
Universal Environmental Services, LLC 411 Dividend Drive Peachtree City, GA 30269	Used Oil Recycling	Preferred Equity Interests	15.0%
Companies Less Than 5% Owned			
Augusta Sportswear Group, Inc. 425 Park West Drive Augusta, GA 30907	Retail Athletic Apparel	Common Stock	1.6%
Axium Healthcare Pharmacy, Inc. 550 Technology Park Lake Mary, FL 32746	Pharmaceutical Services	Common Stock	12.6%
Baird Capital Partners IV Limited Partnership	Private Equity Fund	Limited Partnership Interest	2.5%

777 East Wisconsin Avenue Milwaukee, WI 53201			
BenefitMall, Inc. 4851 LBJ Freeway, Suite 1100 Dallas, TX 75244	Insurance General Agency to Small Businesses	Series B Common Stock(10) Warrant to Purchase Class C Common Stock(10)	85.3% 100.0%
Callidus Debt Partners CLO Fund III, Ltd.(8) 520 Madison Avenue New York, NY 10022	CDO/CLO Fund	Preferred Shares	68.4%
Callidus Debt Partners CLO Fund IV, Ltd.(8) 520 Madison Avenue New York, NY 10022	CDO/CLO Fund	Income Notes	27.5%
Callidus Debt Partners CLO Fund V, Ltd.(8) 520 Madison Avenue New York, NY 10022	CDO/CLO Fund	Income Notes	43.1%
Callidus Debt Partners CLO Fund VI, Ltd.(8) 520 Madison Avenue New York, NY 10022	CDO/CLO Fund	Income Notes	100.0%
Callidus Debt Partners CLO Fund VII, Ltd.(8) 520 Madison Avenue New York, NY 10022	CDO/CLO Fund	Income Notes	50.9%
Callidus MAPS CLO Fund I LLC(8) 520 Madison Avenue New York, NY 10022	CDO/CLO Fund	Income Notes	86.5%
Callidus MAPS CLO Fund II, Ltd.(8) 520 Madison Avenue New York, NY 10022	CDO/CLO Fund	Income Notes	47.1%
Carlisle Wide Plank Floors, Inc. 1676 Route 9 Stoddard, NH 03464	Wide Plank Wood Flooring	Class A-1 Preferred Stock	4.5%
Catterton Partners VI, L.P. 599 West Putnam Avenue Greenwich, CT 06830	Private Equity Fund	Limited Partnership Interest	0.5%

Name and Address of Portfolio Company	Nature of its Principal Business	Title of Securities Held by the Company	Percentage of Class Held
Centre Capital Investors V, LP 30 Rockefeller Plaza New York, NY 10020	Private Equity Fund	Limited Partnership Interest	3.7%
CK Franchising, Inc. 6640 Poe Avenue Suite 200 Dayton, OH 45414	Non-Medical, In-Home Care Franchiser	Preferred Stock Class B Common Stock	28.5% 86.3%
Commercial Credit Group, Inc. 121 West Trade Street Suite 2100 Charlotte, NC 28202	Equipment Finance and Leasing	Series A-1 Preferred Stock Series B Preferred Stock Series C Preferred Stock Series D Preferred Stock Warrant to Purchase Common Stock(10)	43.1% 43.1% 86.3% 44.8% 66.4%
Cook Inlet Alternative Risk, LLC 10 British American Boulevard Latham, NY 12110	Management Services	Equity Interests	3.7%
Cortec Group Fund IV, L.P. 200 Park Avenue New York, NY 10166	Private Equity Fund	Limited Partnership Interest	2.5%
Digital VideoStream, LLC 2600 West Olive Avenue Burbank, CA 91505	Media Post Production	Debt Convertible into Equity Interests	20.8%
DirectBuy Holdings, Inc. 8450 Broadway Merrilville, IN 46410	Franchisor of Consumer Buying Centers	Equity Interests	4.6%
Distant Lands Trading Co. 801 Houser Way North Renton, WA 98055	Provider of Premium Coffee and Coffee Beans	Series A-1 Common Stock Class A Common Stock	8.5% 3.8%
Driven Brands, Inc. (d/b/a Meineke Car Care Centers® and Econo Lube N Tune®) 128 South Tryon Street Suite 900 Charlotte, NC 28202	Franchisor of Car Care Centers	Class B Common Stock(10) Warrant to Purchase Class A Common Stock(10)	84.7% 51.0%

Dryden XVIII Leveraged Loan 2007 Limited Prudential Investment Management Four Gateway Center Newark, NJ 07102	CDO/CLO Fund	Income Notes	80.0%
Dynamic India Fund IV International Financial Services Limited IFS Court, Twenty Eight Cybercity, Ebene, Mauritius	Fund Focused on Real Estate in India	Equity Interests	5.4%
EarthColor, Inc. 249 Pomeroy Road Parsippany, NJ 07054	Full Service Commercial Printer	Class B Common Stock(10) Warrant to Purchase Class C Common Stock(10)	86.3% 100.0%
eCentury Capital Partners, L.P. 8180 Greensboro Drive Suite 1150 McLean, VA 22102	Private Equity Fund	Limited Partnership Interest(6)	25.0%
eInstruction Corporation 308 N. Carroll Blvd. Denton, TX 76201	Provider of Student Response Systems	Class A Common Stock	2.4%
FCP-BHI Holdings, LLC 9432 Southern Pine Boulevard Charlotte, NC 28273	Restaurants	Equity Interests	1.5%
Fidus Mezzanine Capital, L.P. 101 North Tryon Street Charlotte, NC 28246	Private Equity Fund	Limited Partnership Interest(6)	30.0%
Frozen Specialties, Inc. 720 Barre Road Archbold, OH 43502	Private Label Frozen Food Manufacturer	Warrants to Purchase Class A Common Stock	2.5%
Geotrace Technologies, Inc. 1011 Highway 6 South Suite 220 Houston, TX 77077	Oil and Gas Reservoir Analysis	Warrant to Purchase Preferred Stock Warrant to Purchase Common Stock	8.9% 8.1%

Name and Address of Portfolio Company	Nature of its Principal Business	Title of Securities Held by the Company	Percentage of Class Held
Havco Wood Products LLC 3200 East Outer Road Scott City, MO 63780	Hardwood Flooring Products Manufacturer	Equity Interests	4.5%
Higginbotham Insurance Agency, Inc. 500 W. 13th Street Fort Worth, TX 76102	Insurance Brokerage Firm	Class B Common Stock Warrant to purchase Class C Common Stock	87.0% 100.0%
The Homax Group, Inc. P.O. Box 5643 Bellingham, WA 98227	Supplier of Branded Consumer Products	Preferred Stock Common Stock Warrant to Purchase Preferred Stock Warrant to Purchase Common Stock	0.1% 0.1% 1.0% 1.0%
International Fiber Corporation 50 Bridge Street North Tonawanda, NY 14120	Cellulose and Fiber Producer	Series A Preferred Stock	4.0%
Knightsbridge CLO 2007-1 Limited Deutsche Banc Securities Inc. 60 Wall Street New York, NY 10005	CDO/CLO Fund	Income Notes	70.0%
Kodiak Fund LP 2107 Wilson Boulevard Suite 400 Arlington, VA 22201	Real Estate Finance Fund	Equity Interests	4.1%
MedAssets, Inc. 100 North Pointe Center Suite 150 Alpharetta, GA 30022	Healthcare Outsourcing	Common Stock	0.5%
Network Hardware Resale, Inc. 26 Castilian Drive Suite A Santa Barbara, CA 93117	Provider of Pre-Owned Networking Equipment	Debt Convertible into Common Stock	21.8%
Norwesco, Inc. P.O. BOX 439 4365 Steiner St.	Polyethylene Tanks Manufacturer	Class B Common Stock[10] Warrants to Purchase Class A Common Stock[10]	83.2% 50.2%

St. Bonifacius, MN 55375			
Novak Biddle Venture Partners III, L.P. 7501 Wisconsin Avenue East Tower, Suite 1380 Bethesda, MD 20814	Private Equity Fund	Limited Partnership Interest	2.5%
Passport Health Communications, Inc. 720 Cool Springs Blvd Suite 450 Franklin, TN 37067	Healthcare Technology	Preferred Stock Common Stock	5.8% 0.1%
Pendum, Inc. 4600 S. Ulster Street Denver, CO 80237	Outsourced ATM Services Provider	Series C-2 Preferred Stock Warrants to Purchase Class C-2 Common Stock	100.0% 100.0%
Performant Financial Corporation 333 N. Canyons Pkwy Suite 100 Livermore, CA 94551	Collections and Default Prevention Services	Common Stock	2.3%
Peter Brasseler Holdings, LLC One Brasseler Boulevard Savannah, GA 31419	Dental Equipment Distributor	Class A Equity Interests	5.5%
Postle Aluminum Company, LLC 511 Pine Creek Court Elkhart, IN 46516	Aluminum Extrusions Distributor and Manufacturer	Class B Equity Interests	100.0%
Pro Mach, Inc. 6279 Tri-Ridge Boulevard Suite 410 Loveland, OH 45140	Packaging Machinery Manufacturer	Equity Interests	2.2%
Reed Group, Ltd. 10155 Westmoor Drive Suite 210 Westminster, CO 80021	Publisher	Class A Equity Interests	4.2%

Name and Address of Portfolio Company	Nature of its Principal Business	Title of Securities Held by the Company	Percentage of Class Held
S.B. Restaurant Company (d/b/a Elephant Bar) 14241 Firestone Boulevard Suite 315 La Mirada, CA 90638	Restaurants	Series B Convertible Preferred Stock	2.1%
		Warrants to Purchase Series A Common Stock	11.5%
Service Center Metals, LLC 5850 Quality Way Prince George, VA 23875	Manufacturer Aluminum Products	Series C Preferred Equity Interests	2.8%
Snow Phipps Group, L.P. 667 Madison Avenue New York, NY 10021	Private Equity Fund	Limited Partnership Interest	1.6%
SPP Mezzanine Funding II, L.P. 330 Madison Avenue, 28th Floor New York, NY 10017	Private Equity Fund	Limited Partnership Interest(14)	42.7%
Summit Energy Services, Inc. 10350 Ormsby Park Place Suite 400 Louisville, KY 40223	Provider of Energy Management and Procurement Services	Common Stock	2.0%
Tappan Wire and Cable Inc. 100 Bradley Parkway Blauvelt, NY 10913	Manufacturer and Distributor of Cable	Class B Common Stock	86.3%
		Warrant to Purchase Class C Common Stock	100.0%
The Step2 Company, LLC 10010 Aurora-Hudson Road Streetsboro, Ohio 44241	Manufacturer of Plastic Childrens and Home Products	Preferred Equity Interests	3.3%
		Common Equity Interests	3.3%
TransAmerican Auto Parts, LLC 801 West Artesia Boulevard Compton, CA 90220	Auto Parts and Accessories Retailer and Wholesaler	Preferred Equity Interests	1.4%
		Common Equity Interests	1.4%
Triax Holdings, LLC 20 Commerce Drive Suite 232 Cranford, NJ 07016	Pharmaceutical Marketer	Class A Equity Interests	100.0%
		Class B Equity Interests	100.0%
		Common Equity Interests	61.0%
Venturehouse-Cibernet Investors, LLC 509 Seventh Street, N.W. Washington, DC 20004	Third-Party Billing	Equity Interest	3.3%

VICORP Restaurants, Inc. 400 W. 48th Avenue Denver, CO 80216	Restaurants	Warrant to Purchase Preferred Stock Warrant to Purchase Common Stock	1.9% 3.4%
Walker Investment Fund II, LLLP 3060 Washington Road Suite 200 Glenwood, MD 21738	Private Equity Fund	Limited Partnership Interest	5.1%
WMA Equity Corporation and Affiliates (13) 31 West 34th Street New York, NY 10001	Marketer of Children s Apparel	Common Stock	86.3%
Webster Capital II, L.P. 950 Winter Street Suite 4200 Waltham, MA 02451	Private Equity Fund	Limited Partnership Interest	3.5%
Woodstream Corporation 69 North Locust Street Lititz, PA 17543	Pest Control Manufacturer	Common Stock	3.9%
York Insurance Services Group, Inc. 99 Cherry Hill Road Suite 102 Parsippany, NJ 07054	Insurance Claims Administrator	Common Stock	2.2%
COMMERCIAL REAL ESTATE FINANCE(9)			
Aquila Binks Forest Development, LLC(1) 15430 Endeavour Drive Jupiter, FL 33478	Real Estate Developer	Equity Interest	50.0%

Name and Address of Portfolio Company	Nature of its Principal Business	Title of Securities Held by the Company	Percentage of Class Held
MGP Park Place Equity, LLC 6901 Rockledge Drive Suite 230 Bethesda, MD 20817	Commercial Real Estate Development	Equity Interest	70.0%
NPH, Inc.[1] 1919 Pennsylvania Ave, N.W. Washington, DC 20006	Commercial Real Estate Developer	Common Stock	100.0%
Stemmons Freeway Hotel, LLC[1] 1919 Pennsylvania Ave, N.W. Washington, DC 20006	Hotel	Equity Interests	100.0%
WSA Commons LLC 421 East 4th Street Cincinnati, OH 45202	Residential Real Estate Development	Equity Interests	50.0%
WSALD-CEH, LLC[1] 1919 Pennsylvania Ave, N.W. Washington, DC 20006	Commercial Real Estate Developer	Equity Interest	50.0%
Van Ness Hotel, Inc.[1] 1919 Pennsylvania Ave, N.W. Washington, DC 20006	Hotel	Common Stock	100.0%

(1) The portfolio company is deemed to be an affiliated person under the 1940 Act because we hold one or more seats on the portfolio company s board of directors, are the general partner, or are the managing member.

(2) Alaris Consulting, LLC owns 95% of Alaris Consulting, Inc.

(3) Included in Class C Equity Interests in the Consolidated Statement of Investments.

(4) Callidus Capital Corporation owns 80% (subject to dilution) of Callidus Capital Management, LLC.

(5) The affiliate holds subordinated debt issued by Impact Innovations Group, LLC. We made an investment in and exchanged our existing subordinated debt for equity interests in the affiliate.

(6) Limited partnership interests are non-voting.

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

(8) Callidus Capital Management, LLC is the manager of the fund (see Note 4 above).

(9) These portfolio companies are included in the Commercial Real Estate Finance Equity Interests in the Consolidated Statement of Investments.

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

(11) Crescent Equity Corp. holds investments in Crescent Hotels & Resorts, LLC and affiliates and Longview Cable & Data, LLC.

(12) Our affiliate holds 100% of the general partnership interests in the Allied Capital Senior Debt Fund, L.P. (the Fund). See Management s Discussion and Analysis and Results of Operations Allied Capital Senior Debt Fund, L.P. above. We hold 41% of the Class A-1 limited partnership interests in the Fund, however; we only own 26% of the total limited partnership interests in the Fund.

(13) WMA Equity Corporation and Affiliates hold 29.4% of the equity interests in Wear Me Apparel LLC.

DETERMINATION OF NET ASSET VALUE

Quarterly Net Asset Value Determination

We determine the net asset value per share of our common stock quarterly. The net asset value per share is equal to the value of our total assets minus liabilities divided by the total number of common shares outstanding.

We determine the value of each investment in our portfolio on a quarterly basis, and changes in value result in unrealized appreciation or depreciation being recognized in our statement of operations. Value, as defined in Section 2(a)(41) of the 1940 Act, is (i) the market price for those securities for which a market quotation is readily available and (ii) for all other securities and assets, fair value is as determined in good faith by the Board of Directors. Since there is typically no readily available market value for the investments in our portfolio, we value substantially all of our portfolio investments at fair value as determined in good faith by the Board of Directors in accordance with our valuation policy and the provisions of the 1940 Act and FASB Statement No. 157, *Fair Value Measurements* (SFAS 157 or the Statement). We determine fair value to be the price that would be received for an investment in current sale, which assumes an orderly transaction between market participants on the measurement date. At March 31, 2008, portfolio investments recorded at fair value using level 3 inputs (as defined under the Statement) were approximately 91% of our total assets. Because of the inherent uncertainty of determining the fair value of investments that do not have a readily available market value, the fair value of our investments determined in good faith by the Board of Directors may differ significantly from the values that would have been used had a ready market existed for the investments, and the differences could be material.

There is no single approach for determining fair value in good faith. As a result, determining fair value requires that judgment be applied to the specific facts and circumstances of each portfolio investment while employing a consistently applied valuation process for the types of investments we make. Unlike banks, we are not permitted to provide a general reserve for anticipated loan losses. Instead, we are required to specifically value each individual investment on a quarterly basis. We will record unrealized depreciation on investments when we determine that the fair value of a security is less than cost basis, and we will record unrealized appreciation when we determine that the fair value is greater than cost basis. Changes in fair value are recorded in the statement of operations as net change in unrealized appreciation or depreciation.

As a business development company, we invest in illiquid securities including debt and equity securities of portfolio companies, CLO bonds and preferred shares/income notes CDO bonds and investment funds. The structure of each debt and equity security is specifically negotiated to enable us to protect our investment and maximize our returns. We include many terms governing interest rate, repayment terms, prepayment penalties, financial covenants, operating covenants, ownership parameters, dilution parameters, liquidation preferences, voting rights, and put or call rights. Our investments may be subject to certain restrictions on resale and generally have no established trading market.

Because of the type of investments that we make and the nature of our business, our valuation process requires an analysis of various factors. Our fair value methodology includes the examination of, among other things, the underlying investment performance, financial condition, and market changing events that impact valuation. See Business Portfolio Valuation and Management s Discussion and Analysis and Results of Operations Change in Unrealized Appreciation or Depreciation.

Determinations In Connection With Offerings

We are not generally able to issue and sell our common stock at a price below net asset value per share. We may, however, sell our common stock, or sell warrants, options or rights to acquire such common stock, at a price below the current net asset value of the common stock if our board of directors determines that such sale is in our best interests and the best interests of our stockholders, and our stockholders approve our policy and practice of making such sales. In any such case, the price at which our securities are to be issued and sold may not be less than a price which, in the determination of our board of directors, closely approximates the market value of such securities (less any distributing commission or discount).

In connection with each offering of shares of our common stock, the Board of Directors or a committee thereof is required to make the determination that we are not selling shares of our common stock at a price below our then current net asset value at the time at which the sale is made, subject to certain exceptions discussed above. The Board of Directors considers the following factors, among others, in making such determination:

- the net asset value of our common stock disclosed in the most recent periodic report we filed with the SEC;

- our management s assessment of whether any material change in the net asset value has occurred (including through the realization of net gains on the sale of our portfolio investments) from the period beginning on the date of the most recently disclosed net asset value to the period ending two days prior to the date of the sale of our common stock; and

- the magnitude of the difference between the net asset value disclosed in the most recent periodic report we filed with the SEC and our management s assessment of any material change in the net asset value since the date of the most recently disclosed net asset value, and the offering price of the shares of our common stock in the proposed offering.

Importantly, this determination does not require that we calculate net asset value in connection with each offering of shares of our common stock, but instead it involves the determination by the Board of Directors or a committee thereof that we are not selling shares of our common stock at a price below the then current net asset value at the time at which the sale is made, subject to certain exceptions discussed above.

To the extent that there is even a remote possibility that we may issue shares of our common stock at a price below the then current net asset value of our common stock at the time at which the sale is made then the Board of Directors or a committee thereof will elect either to postpone the offering until such time that there is no longer the possibility of the occurrence of such event or to undertake to determine net asset value within two days prior to any such sale to ensure that such sale will not be below our then current net asset value. Moreover, to the extent that there is even a remote possibility that we may trigger the undertaking to suspend the offering of shares of our common stock pursuant to this prospectus if the net asset value fluctuates by certain amounts in certain circumstances until the prospectus is amended, (which we provided to the SEC in the registration statement to which this prospectus is a part) the Board of Directors or a committee thereof will elect to comply with such undertaking or to undertake to determine net asset value to ensure that such undertaking has not been triggered.

These processes and procedures are part of our compliance policies and procedures. Records will be made contemporaneously with all determinations described in this section and these records will be maintained with other records we are required to maintain under the 1940 Act.

MANAGEMENT

Our Board of Directors oversees our management. The responsibilities of the Board of Directors include, among other things, the oversight of our investment activity, the quarterly valuation of our assets, oversight of our financing arrangements and corporate governance activities. The Board of Directors maintains an Executive Committee, Board Investment Review Committee, Audit Committee, Compensation Committee, and Corporate Governance/Nominating Committee, and may establish additional committees from time to time as necessary. All of our directors also serve as directors of our subsidiaries.

The management of our company and our investment portfolio is the responsibility of various corporate committees, including the management committee, the investment committee, and the portfolio management committee. See Portfolio Management.

Structure of Board of Directors

Our Board of Directors is classified into three approximately equal classes with three-year terms, with the term of office of only one of the three classes expiring each year. Directors serve until their successors are elected and qualified.

Directors

Our directors have been divided into two groups interested directors and independent directors. Interested directors are interested persons of Allied Capital as defined in the 1940 Act. Information regarding our Board of Directors at May 6, 2008, is as follows:

Name	Age	Position	Director Since[1]	Expiration of Term
Interested Directors				
William L. Walton	58	Chairman, Chief Executive Officer and President	1986	2010
Joan M. Sweeney	48	Chief Operating Officer [2]	2004	2010
Robert E. Long	77	Director	1972	2010
Independent Directors				
Ann Torre Bates	50	Director	2003	2009
Brooks H. Browne	58	Director	1990	2010
John D. Firestone	64	Director	1993	2011
Anthony T. Garcia	51	Director	1991	2011
Edwin L. Harper	66	Director	2006	2009
Lawrence I. Hebert	61	Director	1989	2011
John I. Leahy	77	Director	1994	2009
Alex J. Pollock	65	Director	2003	2009
Marc F. Racicot	59	Director	2005	2011
Guy T. Steuart II	76	Director	1984	2009
Laura W. van Roijen	56	Director	1992	2011

(1) Includes service as a director of any of the predecessor companies of Allied Capital.

(2) On April 28, 2008, we announced that Ms. Sweeney intends to retire from the company at the end of 2008. Following her retirement, she will continue to serve on our Board of Directors and is expected to enter into a consulting agreement with us.

Each director has the same address as Allied Capital, 1919 Pennsylvania Avenue, N.W., Washington, D.C. 20006.

Executive Officers

Information regarding our executive officers at May 6, 2008, is as follows:

Name	Age	Position
William L. Walton	58	Chairman, Chief Executive Officer and President
Joan M. Sweeney	48	Chief Operating Officer
Kelly A. Anderson	54	Executive Vice President and Treasurer
Scott S. Binder	53	Chief Valuation Officer
Ralph G. Blasey III	47	Executive Vice President and Private Finance General Counsel
John M. Fruehwirth	40	Managing Director and Deputy Head of Private Finance
Michael J. Grisius	44	Managing Director
Jeri J. Harman	50	Managing Director
Miriam G. Krieger	31	Chief Compliance Officer and Corporate Secretary
Thomas C. Lauer	40	Managing Director
G. Scott Lesmes	40	Managing Director
Robert D. Long	51	Managing Director and Head of Asset Management
Justin S. Maccarone	49	Managing Director
Robert M. Monk	41	Managing Director
Diane E. Murphy	54	Executive Vice President and Director of Human Resources
Penni F. Roll	42	Chief Financial Officer
Daniel L. Russell	43	Managing Director
John M. Scheurer	55	Managing Director and Head of Commercial Real Estate Finance
John D. Shulman	45	Managing Director
Suzanne V. Sparrow	42	Executive Vice President and Chief Administrative Officer Managed Funds

Each executive officer has the same address as Allied Capital, 1919 Pennsylvania Avenue, N.W., Washington, D.C. 20006.

Biographical Information

Directors

Our directors have been divided into two groups interested directors and independent directors. Interested directors are interested persons of Allied Capital as defined in the 1940 Act.

Interested Directors

William L. Walton has been Chairman, President and Chief Executive Officer of Allied Capital since 1997 and a director since 1986. Mr. Walton s previous experience includes serving as a Managing Director of Butler Capital Corporation, as personal investment advisor to William S. Paley, founder of CBS, and as Senior Vice President in Lehman Brothers Kuhn Loeb s Merger and Acquisition Group. He also founded two education service companies Language Odyssey and SuccessLab. Mr. Walton currently serves on the boards of the U.S. Chamber of Commerce, Freedom House, and the Financial Services Roundtable, and he is President of the National Symphony Orchestra.

Joan M. Sweeney is the Chief Operating Officer of Allied Capital and has been employed by Allied Capital since 1993. Ms. Sweeney oversees Allied Capital s daily operations. Prior to joining Allied Capital, Ms. Sweeney was employed by Ernst & Young, Coopers & Lybrand, and the Division of Enforcement of the Securities and Exchange Commission.

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Robert E. Long has been the Chief Executive Officer and a director of GLB Group, Inc., an investment management firm, since 1997 and President of Ariba GLB Asset Management, Inc., the parent company of GLB Group, Inc., since 2005. He has been the Chairman of Emerald City Radio Partners, LLC since 1997. Mr. Long was the President of Business News Network, Inc. from 1995 to 1998, the Chairman and Chief Executive Officer of Southern Starr Broadcasting Group, Inc. from 1991 to 1995, and a director and the President of Potomac Asset Management, Inc. from 1983 to 1991. Mr. Long is a director of AmBase Corporation, CSC Scientific, Inc., and Advanced Solutions International, Inc. He has served as a director of Allied Capital or one of its predecessors since 1972. Mr. Long is the father of Robert D. Long, an executive officer of Allied Capital.

Independent Directors

Ann Torre Bates has been a strategic and financial consultant since 1997. From 1995 to 1997, Ms. Bates served as Executive Vice President, CFO and Treasurer of NHP, Inc., a national real estate services firm. From 1991 to 1995, Ms. Bates was Vice President and Treasurer of US Airways. She currently serves on the boards of Franklin Mutual Series Funds, the Franklin Mutual Recovery Fund, the Franklin Templeton Funds, and SLM Corporation (Sallie Mae).

Brooks H. Browne has been a private investor since 2002. Mr. Browne was the President of Environmental Enterprises Assistance Fund from 1993 to 2002 and served as a director from 1991 to 2005. He currently serves as Chairman of the Board for Winrock International, a non-profit organization.

John D. Firestone has been a Partner of Secor Group, a venture capital firm since 1978. Mr. Firestone has also served as a director of Security Storage Company of Washington, DC, since 1978. He is currently a director of Cuisine Solutions, Inc., and several non-profit organizations.

Anthony T. Garcia has been a private investor since March 2007. Previously, Mr. Garcia was Vice President of Finance of Kirusa, a developer of mobile services, from January to March 2007, and was a private investor from 2003 through 2006. Mr. Garcia was Vice President of Finance of Formity Systems, Inc., a developer of software products for business management of data networks, from 2002 through 2003. Mr. Garcia was a private investor from 2000 to 2001, the General Manager of Breen Capital Group, an investor in tax liens, from 1997 to 2000, and a Senior Vice President of Lehman Brothers Inc. from 1985 to 1996.

Edwin L. Harper has been an executive for Assurant, Inc., a financial services and insurance provider, since 1998. He currently serves as Senior Vice President, Public Affairs and Government Relations and previously served as Chief Operating Officer and Chief Financial Officer for Assurant s largest subsidiary. From 1992 to 1997, Mr. Harper served as President and Chief Executive Officer of the Association of American Railroads. He also spent five years with Campbell Soup Company, serving as Chief Financial Officer from 1986 to 1991. Earlier in his career, Mr. Harper served on the White House staffs of both President Reagan and President Nixon. Mr. Harper currently serves as Director for the Council for Excellence in Government.

Lawrence I. Hebert is Chairman of Dominion Advisory Group, LLC, a provider of anti-money laundering consulting services, and served as Senior Advisor at PNC Bank from 2005 to 2007. He served as a director and President and Chief Executive Officer of Riggs Bank N.A., a subsidiary of Riggs National Corporation, from 2001 to 2005. Mr. Hebert also served as Chief Executive Officer of Riggs National Corporation during 2005 and served as a director of Riggs National Corporation from 1988 to 2005. Mr. Hebert served as a director of Riggs Investment Advisors and Riggs Bank Europe Limited (both indirect subsidiaries of Riggs National Corporation). Mr. Hebert previously served as Vice Chairman from 1983 to 1998, President from 1984 to 1998, and Chairman and Chief Executive Officer from 1998 to 2001 of Allbritton Communications Company.

John I. Leahy has been the President of Management and Marketing Associates, a management consulting firm, since 1986. Previously, Mr. Leahy spent 34 years of his career with Black & Decker Corporation, where he served as President and CEO of the United States subsidiary from 1979 to 1981 and President and Group Executive Officer of the Western Hemisphere of Black & Decker Corporation from 1982 to 1985. Mr. Leahy is currently a director of B&L Sales, Inc. and Chairman of Integra Health Management, Inc. He is also Trustee Emeritus of the Sellinger School of Business at Loyola College, Maryland.

Alex J. Pollock has been a Resident Fellow at the American Enterprise Institute since 2004. He was President and Chief Executive Officer of the Federal Home Loan Bank of Chicago from 1991 to 2004. He currently serves as a director of the CME Group, Great Lakes Higher Education Corporation, the Great Books Foundation, the Illinois Council on Economic Education and the International Union for Housing Finance.

Marc F. Racicot has served as President and Chief Executive Officer of the American Insurance Association since August 2005. Prior to that, he was an attorney at the law firm of Bracewell & Giuliani, LLP from 2001 to 2005. He is a former Governor (1993 to 2001) and Attorney General (1989 to 1993) of the State of Montana. Mr. Racicot was appointed by President Bush to serve as the Chairman of the Republican National Committee from 2002 to 2003 and he served as Chairman of the Bush/Cheney Re-election Committee from 2003 to 2004. He presently serves on the Board of Directors for Burlington Northern Santa Fe Corporation, Massachusetts Mutual Life Insurance Company, and the Board of Visitors for the University of Montana School of Law.

Guy T. Steuart II has been a director of Steuart Investment Company, which manages, operates, and leases real and personal property and holds stock in operating subsidiaries engaged in various businesses, since 1960 where he served as President until 2003 and currently serves as Chairman. Mr. Steuart has served as Trustee Emeritus of Washington and Lee University since 1992.

Laura W. van Roijen has been a private investor since 1992. Ms. van Roijen was a Vice President at Citicorp from 1980 to 1990.

Executive Officers who are not Directors

Kelly A. Anderson, Executive Vice President and Treasurer, has been employed by Allied Capital since 1987. Ms. Anderson s responsibilities include Allied Capital s infrastructure operations, business process management, and certain treasury functions.

Scott S. Binder, Chief Valuation Officer, has been employed by Allied Capital since 1997. He has served as Chief Valuation Officer since 2003. He served as a consultant to the Company from 1991 until 1997. Prior to joining the Company, Mr. Binder formed and was President of Overland Communications Group. He also served as a board member and financial consultant for a public affairs and lobbying firm in Washington, DC. Mr. Binder founded Lonestar Cablevision in 1986, serving as President until 1991. In the early 1980 s, Mr. Binder worked for two firms specializing in leveraged lease transactions. From 1976 to 1981, he was employed by Coopers & Lybrand.

Ralph G. Blasey III, Executive Vice President and Private Finance General Counsel, has been employed by Allied Capital since 2004. Prior to joining Allied Capital, Mr. Blasey practiced law from 1987 to 2004. He joined the law firm of Baker & Hostetler, LLP in 1989 and was named a partner in 1996.

John M. Fruehwirth, Managing Director and Deputy Head of Private Finance, has been employed by Allied Capital since 2003. Previously, he worked at Wachovia Securities (previously First Union Securities) in several merchant banking groups including Wachovia Capital Partners, Leveraged Capital and Middle Market Capital from 1999 to 2003. Prior to that, Mr. Fruehwirth worked in First Union s Leveraged Finance Group from 1996 to 1998.

Michael J. Grisius, Managing Director, has been employed by Allied Capital since 1992. Prior to joining Allied Capital, Mr. Grisius worked in leveraged finance at Chemical Bank from 1989 to 1992 and held senior accountant and consultant positions with KPMG LLP from 1985 to 1988.

Jeri J. Harman, Managing Director, has been employed by Allied Capital since 2004. Prior to joining Allied Capital, Ms. Harman served as a Managing Director and Principal for American Capital Strategies, Ltd., a business development company, from 2000 until 2004. She worked as a Managing Director and Head of Private Placements for First Security Van Kasper from 1996 to 2000 and a Managing Director of

Coopers & Lybrand from 1993 to 1996. From 1982 to 1993, Ms. Harman held various senior level positions in the private placement arm of The Prudential Insurance Company of America. She has served on the Board of Directors for the Association of Corporate Growth since 2000 and currently serves on the Board of the Women s Leadership Council.

Miriam G. Krieger, Chief Compliance Officer and Corporate Secretary, has been employed by Allied Capital since March 2008. Prior to joining Allied Capital, Ms. Krieger served as Senior Vice President and Chief Compliance Officer at MCG Capital Corporation from 2006 to 2008 and Vice President and Assistant General Counsel from 2004 to 2006. From 2001 to 2004, she was an associate in the Financial Services Group of the law firm of Sutherland Asbill & Brennan LLP.

Thomas C. Lauer, Managing Director, has been employed by Allied Capital since 2004. Prior to joining Allied Capital, Mr. Lauer worked in GE Capital s sponsor finance group from 2003 to 2004 and in the merchant banking and leveraged finance groups of Wachovia Securities (previously First Union Securities) from 1997 to 2003. He also held senior analyst positions at Intel Corporation and served as a corporate lender and credit analyst at National City Corporation.

G. Scott Lesmes, Managing Director, has been employed by Allied Capital since July 2007. Prior to joining Allied Capital, Mr. Lesmes served as Senior Vice President and Deputy General Counsel at Fannie Mae from 2005 to 2007 where he was responsible for corporate, securities and securitization legal matters. From 2000 to 2005, he was a Vice President and Deputy General Counsel for corporate and securities matters at Fannie Mae.

Robert D. Long, Managing Director and Head of Asset Management, has been employed by Allied Capital since 2002 and currently manages business development activities. Prior to joining Allied Capital, Mr. Long was Managing Director and Head of Investment Banking at C.E. Unterberg from 2001 to 2002, and Managing Director at E*OFFERING/Wit SoundView from 2000 to 2001. He also held management positions at Bank of America (Montgomery Securities) from 1996 to 2000, and Nomura Securities International from 1992 to 1996, and prior to that he served as a Managing Director at CS First Boston.

Justin S. Maccarone, Managing Director, has been employed by Allied Capital since 2005. Prior to joining Allied Capital, Mr. Maccarone served as a partner with UBS Capital Americas, LLC, a private equity fund focused on middle market investments, from 1993 to 2005. Prior to that, Mr. Maccarone served as a Senior Vice President at GE Capital specializing in merchant banking and leveraged finance from 1989 to 1993 and served as Vice President of the Leveraged Finance Group at HSBC/ Marine Midland Bank from 1981 to 1989.

Robert M. Monk, Managing Director, has been employed by Allied Capital since 1993. Prior to joining Allied Capital, Mr. Monk worked in the leveraged finance group at First Union Securities (currently Wachovia Securities).

Diane E. Murphy, Executive Vice President and Director of Human Resources, has been employed by Allied Capital since 2000. Prior to joining Allied Capital, Ms. Murphy was employed by Allfirst Financial from 1982 to 1999 and served in several capacities including head of the retail banking group in the Greater Washington Metro Region from 1994 to 1996 and served as the senior human resources executive from 1996 to 1999.

Penni F. Roll, Chief Financial Officer, has been employed by Allied Capital since 1995. Ms. Roll is responsible for Allied Capital s financial operations. Prior to joining Allied Capital, Ms. Roll was employed by KPMG LLP in the firm s audit practice.

Daniel L. Russell, Managing Director, has been employed by Allied Capital since 1998. Prior to joining Allied Capital, Mr. Russell was employed by KPMG LLP in the firm s financial services group.

John M. Scheurer, Managing Director and Head of Commercial Real Estate Finance, has been employed by Allied Capital since 1991. Mr. Scheurer is currently a member of the Board of Governors of the Commercial Mortgage Securities Association. He has also served as Chairman and as a Vice Chair of the Capital Markets Committee for the Commercial Real Estate Finance Committee of the Mortgage Bankers Association.

John D. Shulman, Managing Director, has been employed by Allied Capital since 2001. Prior to joining Allied Capital, Mr. Shulman served as the President and CEO of Onyx International, LLC, a private equity firm, from 1994 to 2001. He currently serves as a member of the investment committee of Greater China Private Equity Fund.

Suzanne V. Sparrow, Executive Vice President and Chief Administrative Officer for Managed Funds, has been employed by Allied Capital since 1987. Ms. Sparrow s responsibilities include the Company s fund management activities and various special projects for Allied Capital.

Committees of the Board of Directors

Our Board of Directors has established an Executive Committee, an Audit Committee, a Compensation Committee, and a Corporate Governance/ Nominating Committee. In January 2008, the Board of Directors also established a Board Investment Review Committee. From time to time, the Board may establish special purpose committees to address particular matters on behalf of the Board. The Audit Committee, Compensation Committee, and Corporate Governance/ Nominating Committee each operate pursuant to a committee charter. The charter of each Committee is available on our web site at www.alliedcapital.com in the Investor Resources section and is also available in print to any stockholder or other interested party who requests a copy.

The following table indicates the current members of the committees of the Board of Directors. All of the directors are independent directors, except for Messrs. Walton and Long, and Ms. Sweeney, who are interested persons as defined in Section 2(a)(19) of the 1940 Act.

	Executive Committee	Board Investment Review Committee	Audit Committee	Compensation Committee	Corporate Governance/ Nominating Committee
William L. Walton	Chair	Chair(1)			
Ann Torre Bates		Member	Chair		
Brooks H. Browne	Member	Member	Member	Member	
John D. Firestone		Member		Member	Member
Anthony T. Garcia		Member	Member	Chair	
Edwin L. Harper		Member	Member		
Lawrence I. Hebert	Member	Member(1)		Member	Chair
John I. Leahy		Member(1)		Member	
Robert E. Long	Member	Member(1)			
Alex J. Pollock	Member	Member(1)			Member
Marc F. Racicot	Member	Member		Member	Member
Guy T. Steuart II		Member			Member
Joan M. Sweeney		Member			
Laura W. van Roijen		Member	Member		

(1) Permanent member for 2008.

The Executive Committee. The Executive Committee has and may exercise those rights, powers, and authority that the Board of Directors from time to time grants to it, except where action by the Board is required by statute, an order of the Securities and Exchange Commission (the Commission), or Allied Capital s charter or bylaws. During 2007, the Executive Committee was delegated authority from the Board to review and approve certain investments. The Executive Committee met 42 times during 2007.

The Board Investment Review Committee. In January 2008, the Board established a Board Investment Review Committee and delegated authority to it to review and approve certain types of investments, a role previously undertaken by the Executive Committee. The Board Investment Review Committee is composed of five permanent members, who have been appointed to serve for the year, and three additional members, each of whom will serve during at least one quarter during the year on a rotating schedule.

The Audit Committee. The Audit Committee operates pursuant to a charter approved by the Board of Directors and meets the requirements of Section 3(a)(58)(A) of the Securities Exchange Act of 1934 (the Exchange Act). The charter sets forth the responsibilities of the Audit Committee. The primary function of the Audit Committee is to serve as an independent and objective party to assist the Board of Directors in fulfilling its responsibilities for overseeing and monitoring the quality and integrity of our financial statements, the adequacy of our system of internal controls, the review of the independence, qualifications and performance of our independent registered public accounting firm, and the performance of our internal audit function. The Audit Committee met 18 times during 2007. None of the members of the Audit Committee is an interested person of Allied Capital as defined in Section 2(a)(19) of the 1940 Act, pursuant to the requirements of the rules promulgated by the NYSE. In addition, our Board of Directors has determined that Ms. Bates and Messrs. Browne, Garcia, and Harper are audit committee financial experts as defined under Item 407(d)(5) of Regulation S-K of the Exchange Act, as each meets the experience requirements of Rule 10A-3 of the Exchange Act.

The Compensation Committee. The Compensation Committee approves the compensation of our executive officers, and reviews the amount of salary and bonus for each of our other officers and employees. In addition, the Compensation Committee approves stock option grants for our officers under our Amended Stock Option Plan, and determines other compensation arrangements for employees. None of the members of the Compensation Committee is an interested person of Allied Capital as defined in Section 2(a)(19) of the 1940 Act, pursuant to the requirements of the rules promulgated by the NYSE. The Compensation Committee met 13 times during 2007.

The Corporate Governance/ Nominating Committee. The Corporate Governance/ Nominating Committee recommends candidates for election as directors to the Board of Directors and makes recommendations to the Board as to our corporate governance policies. None of the members of the Corporate Governance/ Nominating Committee is an interested person of Allied Capital as defined in Section 2(a)(19) of the 1940 Act, pursuant to the requirements of the rules promulgated by the NYSE. The Corporate Governance/ Nominating Committee met six times during 2007.

The Corporate Governance/ Nominating Committee will consider qualified director nominees recommended by stockholders when such recommendations are submitted to the care of the Corporate Secretary in accordance with our bylaws, Corporate Governance Policy, and any other applicable law, rule or regulation regarding director nominations. When submitting a nomination for consideration, a stockholder must provide certain information that would be required under applicable Commission rules, including the following minimum information for each director nominee: full name, age and address; principal occupation during the past five years; current directorships on publicly held companies and investment companies; number of shares of our common stock owned, if any; and, a written consent of the individual to stand for election if nominated by the Board of Directors and to serve if elected by the stockholders.

PORTFOLIO MANAGEMENT

The management of our company and our investment portfolio is the responsibility of various corporate committees, including the management committee, the investment committee, and the portfolio management committee. In addition, the Board Investment Review Committee approves certain investment decisions.

Our management committee is responsible for, among other things, business planning and the establishment and review of general investment criteria. The management committee is chaired by William Walton, our Chief Executive Officer (CEO), and currently includes Joan Sweeney, our Chief Operating Officer (COO), Penni Roll, our Chief Financial Officer (CFO), Scott Binder, our Chief Valuation Officer (CVO), and John Fruehwirth, Michael Grisius, Thomas Lauer, Robert D. Long, Justin Maccarone, Robert Monk, Daniel Russell, John Scheurer, and John Shulman, all managing directors. The composition of the committee may change from time to time.

Our investment committee is responsible for approving new investments. Our investment committee is chaired by William Walton, CEO, and currently includes Joan Sweeney, COO, Penni Roll, CFO, Scott Binder, CVO (non-voting), John Fruehwirth, Michael Grisius (vice chairman of the committee), Thomas Lauer, Robert D. Long, Justin Maccarone, Robert Monk, Daniel Russell (vice chairman of the committee), John Scheurer, and John Shulman, all managing directors. The composition of the committee may change from time to time.

In addition to approval by the investment committee, each transaction that represents a commitment equal to or greater than $20 million, every buyout transaction, and any other investment that in our judgment demonstrates unusual risk/reward characteristics also requires the approval of the Board Investment Review Committee. The Board Investment Review Committee is composed of five permanent members, who have been appointed to serve for the year, and three additional members, each of whom will serve during at least one quarter during the year on a rotating schedule. See Committees of the Board of Directors above for the current membership.

Our portfolio management committee is responsible for review and oversight of the investment portfolio, including reviewing the performance of selected portfolio companies, overseeing portfolio companies in workout status, reviewing and approving certain modifications or amendments to or certain additional investments in existing portfolio companies, reviewing and approving certain portfolio exits, reviewing and approving certain actions by portfolio companies whose voting securities are more than 50% owned by us, reviewing significant investment-related litigation matters where we are a named party and approving related activities, and reviewing and approving proxy votes with respect to our portfolio investments. From time to time we will identify investments that require closer monitoring or become workout assets. We develop a workout strategy for workout assets and the portfolio management committee gauges our progress against the strategy. Our portfolio management committee is chaired by William Walton, CEO, and currently includes Joan Sweeney, COO, Penni Roll, CFO, Scott Binder, CVO (non-voting), Ralph Blasey, Private Finance General Counsel, and Christina DelDonna, Susan Mayer, and John Scheurer, all managing directors. The composition of the committee may change from time to time.

We are internally managed and our investment professionals manage the investments in our portfolio. These investment professionals have extensive experience in managing investments in private businesses in a variety of industries, and are familiar with our approach of lending and investing. Because we are internally managed, we pay no external investment advisory fees, but instead we pay the operating costs associated with employing investment and other professionals.

Biographical Information for Non-Executive Officers

Information regarding the business experience of the additional investment professionals who are directors or executive officers is contained under the caption Management Biographical Information.

Christina L. DelDonna, Managing Director, has been employed by Allied Capital since 1992. Ms. DelDonna has previously worked in a number of other managerial roles during her tenure with Allied

Capital. Prior to joining Allied Capital, Ms. DelDonna held several accounting, audit, and financial analyst roles within a variety of industries.

Susan Mayer, Managing Director, has been employed by Allied Capital since 2003. Prior to joining Allied Capital, Ms. Mayer served in various investment and management positions with MCI Communications Corporation from 1993 to 2003. Before joining MCI, Ms. Mayer served in a variety of corporate development, management, and consulting roles and was employed by NHP, Inc. from 1991 to 1993, Comsat, Inc. from 1986 to 1991, and the Boston Consulting Group from 1979 to 1986.

Compensation

The compensation for the members of our management committee, investment committee, and portfolio management committee includes: (i) annual base salary; (ii) annual cash bonus; (iii) stock options, priced at current market value; and (iv) individual performance award and/or individual performance bonus. Compensation for the members of our Board Investment Review Committee, with the exception of Mr. Walton, consists of: (i) annual retainers; (ii) annual committee retainers; and (iii) stock options. The compensation of the members of the management committee, investment committee and portfolio management committee is determined in the same manner as the compensation received by our named executive officers. See Management and Compensation of Directors and Executive Officers for additional information regarding our compensation program and our determination of individual compensation.

Beneficial Ownership

Messrs. Walton, Browne, Firestone, Garcia, and Steuart, and Mmes. Sweeney and van Roijen, all members of the Board Investment Review Committee, beneficially own shares of our common stock with a value of more than $1,000,000, based on the closing price of $19.89 on May 6, 2008. Messrs. Long, Hebert, Leahy and Pollock and Ms. Bates, all members of the Board Investment Review Committee, beneficially own shares of our common stock with a value of $500,001 to $1,000,000, based on the May 6, 2008, closing price. Mr. Harper, member of the Board Investment Review Committee, beneficially owns shares of our common stock with a value of $100,001 to $500,000, based on the May 6, 2008, closing price, and Mr. Racicot, member of the Board Investment Review Committee, beneficially owns shares of our common stock with a value of $10,001 to $50,000, based on the May 6, 2008, closing price. Each member of the investment committee, management committee and the portfolio management committee beneficially owns shares of our common stock with a value of more than $1,000,000, based on the May 6, 2008 closing price.

Conflicts of Interest

Certain of the members of the Board Investment Review Committee, the management committee, the investment committee, and the portfolio management committee serve or may serve in an investment management capacity to funds managed by us. Specifically, the credit committees and the investment committees of our Managed Funds include certain of our officers, including our CEO, who serve in similar roles for us. These investment professionals intend to allocate such time and attention as is deemed appropriate and necessary to carry out the operations of the managed funds effectively. In this respect, they may experience diversions of their attention from us and potential conflicts of interest between their work for us and their work for the managed funds in the event that the interests of the managed funds run counter to our interests. Accordingly, they may have obligations to investors in the managed funds, the fulfillment of which might not be in the best interests of us or our shareholders. See Risk Factors There are potential conflicts of interest between us and the funds managed by us.

COMPENSATION OF DIRECTORS AND EXECUTIVE OFFICERS

Under SEC rules applicable to business development companies, we are required to set forth certain information regarding the compensation of certain executive officers and directors. The following tables set forth compensation earned during the year ended December 31, 2007, by all of our directors, our principal executive officer, our principal financial officer, and each of our three highest paid executive officers (collectively, the Named Executive Officers or NEOs) in each capacity in which each NEO served. Certain of the NEOs served as both officers and directors.

DIRECTOR COMPENSATION

The following table sets forth compensation that we paid during the year ended December 31, 2007, to our directors. Our directors have been divided into two groups interested directors and independent directors. Interested directors are interested persons as defined in Section 2(a)(19) of the 1940 Act.

Name	Fees Earned or Paid in Cash	Stock Awards	Option Awards[1]	Non-Equity Incentive Plan Compensation	Change in Pension Value and Non-qualified Deferred Compensation Earnings[3]	All Other Compensation[4]	Total
Interested Directors							
William L. Walton[2]	$	n/a	$	n/a	n/a	$	$
Joan M. Sweeney[2]	$	n/a	$	n/a	n/a	$	$
Robert E. Long	$ 145,000	n/a	$ 14,884	n/a	n/a	$ 39,367	$ 199,251
Independent Directors							
Ann Torre Bates	$ 237,000	n/a	$ 14,884	n/a	n/a	$ 15,465	$ 267,349
Brooks H. Browne	$ 208,000	n/a	$ 14,884	n/a	n/a	$ 15,593	$ 238,477
John D. Firestone	$ 190,000	n/a	$ 14,884	n/a	n/a	$ 39,367	$ 244,251
Anthony T. Garcia	$ 195,000	n/a	$ 14,884	n/a	n/a	$ 62,110	$ 271,994
Edwin L. Harper	$ 254,500	n/a	$ 14,884	n/a	n/a	$	$ 269,384
Lawrence I. Hebert	$ 222,000	n/a	$ 14,884	n/a	n/a	$ 62,110	$ 298,994
John I. Leahy	$ 190,000	n/a	$ 14,884	n/a	n/a	$ 58,542	$ 263,426
Alex J. Pollock	$ 199,000	n/a	$ 14,884	n/a	n/a	$ 13,758	$ 227,642
Marc F. Racicot	$ 286,000	n/a	$ 14,884	n/a	n/a	$ 14,490	$ 315,374
Guy T. Steuart II	$ 190,000	n/a	$ 14,884	n/a	n/a	$ 62,110	$ 266,994
Laura W. van Roijen	$ 211,000	n/a	$ 14,884	n/a	n/a	$ 15,593	$ 241,477

(1) Reflects the annual grant of 5,000 options. Options granted vested immediately. The fair value of the options was estimated on the grant date for financial reporting purposes using the Black-Scholes option pricing model and pursuant to the requirements of FASB Statement No. 123 (Revised), or SFAS 123R. See Note 2 to our Consolidated Financial Statements for the year ended December 31, 2007, for the assumptions used in determining SFAS 123R values.

(2) Mr. Walton and Ms. Sweeney did not receive any compensation for serving on the Board of Directors. See Summary Compensation Table below.

(3) There were no above market or preferential earnings on the non-qualified deferred compensation plans. See Non-Qualified Deferred Compensation below.

(4) Represents the SFAS 123R expense related to stock options cancelled in connection with the option cancellation payment (OCP). See Option Cancellation and the OCP below.

During 2007, our Board of Directors adopted and implemented the following compensation structure for non-officer directors, which is also effective for 2008. Each non-officer director receives an annual retainer of $100,000. In addition, each member of each committee receives an annual retainer of $45,000 to attend the meetings of the committee, with a maximum of $90,000 to be paid to any one director for committee retainers. Each committee chair also receives an annual retainer of $5,000. In addition, members who serve on special purpose committees receive $3,000 per meeting. We also reimburse directors for expenses related to meeting attendance. Directors who are employees receive no additional compensation for serving on our Board of Directors or its committees.

For 2007, directors could choose to defer any portion of their cash compensation through the 2005 Allied Capital Non-Qualified Deferred Compensation Plan, and could choose to have such deferred income invested in shares of the Company s common stock through a trust, which is owned by the Company. See Non-Qualified Deferred Compensation for additional information.

Non-officer directors are eligible for stock option awards under our Amended Stock Option Plan pursuant to an exemptive order from the Commission, which was granted in September 1999. The terms of the order provided for a one-time grant of 10,000 options to each non-officer director on the date that the order was issued, or on the date that any new director is elected by stockholders to the Board of Directors. Thereafter, each non-officer director will receive 5,000 options each year on the date of the Annual Meeting of Stockholders at the fair market value on the date of grant. See Amended Stock Option Plan. The options granted to our directors vest immediately.

EXECUTIVE COMPENSATION

Compensation Discussion and Analysis

Overview of the Compensation Program

Compensation Philosophy. Allied Capital s compensation and benefits programs are designed with the goal of providing compensation that is fair, reasonable and competitive. The programs are intended to help us align the compensation paid to our executive officers with the achievement of certain corporate and executive performance objectives that have been established to achieve the long-term objectives of Allied Capital. We also believe that the compensation programs should enable us to attract, motivate, and retain key officers who will contribute to our future success.

The design of our compensation programs is based on the following three guiding factors:

Achievement of Corporate and Individual Performance Objectives We believe that the best way to accomplish alignment of compensation with the interests of our stockholders is to link pay to individual performance and individual contributions to the returns generated for stockholders. Compensation is determined on a discretionary basis and is dependent on the achievement of certain corporate and individual performance objectives that have been established to achieve long-term objectives of Allied Capital. When individual performance exceeds expectations and performance goals established during the year, pay levels for the individual are expected to be above competitive market levels. When individual performance falls below expectations, pay levels are expected to be below competitive levels.

Competitiveness and Market Alignment Our compensation and benefits programs are designed to be competitive with those provided by companies with whom we compete for talent and to be sufficient to attract the best talent from an increasingly competitive market for top performers in the private equity industry. Benefit programs are designed to provide competitive levels of protection and financial security and are not based on performance. As part of its annual review process, the Compensation Committee reviews the competitiveness of our current compensation levels of our key employees and executives with a third-party compensation consultant against the competitive market and relative to overall corporate performance during the year. The Compensation Committee also reviews tally sheets annually, which illustrate all components of compensation for the NEOs.

Alignment with Requirements of the 1940 Act Our compensation program must align with the requirements of the 1940 Act, which imposes certain limitations on the structure of a BDC s compensation program. For example, the 1940 Act prohibits a BDC from maintaining a stock option plan and a profit sharing arrangement simultaneously. As a result, if a BDC has a stock option plan, it is prohibited from using a carried interest formula, a common form of compensation in the private equity industry, as a form of compensation. Because of these and other similar limitations imposed by the 1940 Act, the Compensation Committee is limited as to the type of compensation arrangements that can be utilized in order to attract, retain and motivate employees.

Components of Total Compensation. The Compensation Committee determined that the compensation packages for 2007 for the NEOs should generally consist of the following five key components:

Annual base salary;

Annual cash bonus;

Stock options, priced at current market value;

Individual Performance Award (IPA), which is a cash award that is generally determined at the beginning of the year based upon the individual performance of the officer, which during 2006 and 2007 was used exclusively to purchase shares of our common stock in the market through a deferred compensation plan; and

Individual Performance Bonus (IPB), which is a cash award that is generally determined at the beginning of the year based upon the individual performance of the officer and is paid as current compensation during the year.

Base Salary. Base salary is designed to attract and retain experienced executives who can drive the achievement of our goals and objectives. While an executive s initial base salary is determined by an assessment of competitive market levels, the factors used in determining increases in base salary include individual performance, changes in role and/or responsibility and changes in the competitive market environment.

We have entered into employment agreements with William L. Walton, our Chairman and Chief Executive Officer, Joan M. Sweeney, our Chief Operating Officer, and Penni F. Roll, our Chief Financial Officer. See Employment Agreements below for information regarding the material terms of these agreements.

Annual Cash Bonus. The annual cash bonus is designed to reward those executives that have achieved certain corporate and executive performance objectives and have contributed to the achievement of certain long-term objectives of Allied Capital. The amount of the annual cash bonus is determined by the Compensation Committee on a discretionary basis. The annual cash bonus, when combined with base salary and the IPA and IPB described below, is benchmarked against a range of compensation that is competitive between the median (50th percentile) and 75th percentile of market compensation levels based on the performance of the individual.

Stock Options. Our principal objective in awarding stock options to our officers and directors is to align each optionee s interests with the success of Allied Capital and the financial interests of our stockholders by linking a portion of such optionee s compensation with the performance of our stock and the value delivered to stockholders. The Compensation Committee evaluates a number of criteria, including the past service of each such optionee to Allied Capital, the present and potential contributions of such optionee to the success of Allied Capital, and such other factors as the Compensation Committee shall deem relevant in connection with accomplishing the purposes of the Amended Stock Option Plan, including the recipient s current stock holdings, years of service, position with us, and other factors. The Compensation Committee does not apply a formula assigning specific weights to any of these factors when making its determination. The Compensation Committee awards stock options on a subjective basis and such awards depend in each case on the performance of the officer under consideration, and in the case of new hires, their potential performance. See Amended Stock Option Plan for additional information.

IPA. Following the enactment of The Sarbanes-Oxley Act of 2002, we were no longer permitted to provide loans to executive officers for the exercise of stock options, as is statutorily provided for in the 1940 Act. This was a significant development, since a substantial component of the total return to stockholders comes in the form of the dividend paid on our common stock. Under the former loan program, an officer could exercise vested stock options with a loan for the purpose of buying the underlying shares and would then receive dividends on the shares obtained through such exercise and pay us interest on the loan until maturity. The loan program caused the officers to share in the risk of ownership of the stock, since the loan would have to be repaid. As such, under the loan program, there was a balance of the benefits and risks of share ownership for the officers.

When the loan program was discontinued, the Compensation Committee established a long-term incentive compensation program whereby the Compensation Committee of the Board of Directors determines an IPA for certain officers annually, generally at the beginning of each year. In determining the award for any one officer, the Compensation Committee considers individual performance factors, as well as the individual s contribution to the returns generated for stockholders, among other factors. Stockholders approved the Non-Qualified Deferred Compensation Plan II (DCP II), through which the IPA is administered, in 2004. See Non-Qualified Deferred Compensation The 2005 Deferred Compensation Plan II for additional detail regarding the determination by the Board of Directors to terminate our deferred compensation arrangements in 2008. For 2008, the Compensation Committee has determined that the IPAs will be paid in cash generally in two equal installments during the year to eligible officers, as long as the recipient remains employed by us.

IPB. As a result of changes in the Code regarding non-qualified deferred compensation plans, as well as an increase in the competitive market for recruiting and retaining top performers in private equity firms, beginning in 2005 the Board of Directors determined that a portion of the IPA should be paid as an IPB. The IPB is determined annually, generally at the beginning of the year, and is distributed in cash in equal installments to award recipients throughout the year as long as each recipient remains employed by us. If a recipient terminates employment during the year, any remaining cash payments under the IPB would be forfeited. In determining an IPB award for any one officer, the Compensation Committee considers individual performance factors, as well as the individual s contribution to the returns generated for stockholders, among other factors.

Employment Agreements and Severance Arrangements. We entered into employment agreements in 2004 with Mr. Walton and Mmes. Sweeney and Roll. These agreements were reviewed in 2007 and amended to comply with regulatory changes in the Code and to address other tax related matters. Pursuant to each of these agreements, if the executive s employment is terminated without cause during the term of the agreement, or within 24 months of a change in control, the executive shall be entitled to severance pay. See Severance and Change in Control Arrangements for more detail.

401(k) Plan. We maintain a 401(k) Plan. All employees who are at least 21 years of age have the opportunity to contribute pre-tax of after-tax salary deferrals to the 401(k) Plan, up to $15,500 annually for the 2008 plan year, and to direct the investment of these contributions. Plan participants who are age 50 or older during the 2008 plan year are eligible to defer an additional $5,000 during 2008. The 401(k) Plan allows eligible participants to invest in the Allied Capital Stock Fund, consisting of Allied Capital common stock and cash, among other investment options. The 401(k) Plan held less than 1% of our outstanding shares.

During the 2007 plan year, we contributed up to 5% of each participant s eligible compensation for the year, up to maximum compensation of $225,000, to each participant s plan account on the participant s behalf, which fully vested at the time of the contribution. For 2007, our contribution with respect to compensation in excess of $225,000 was made in cash to the participant in the first quarter of 2008.

For the 2008 plan year, we amended our 401(k) Plan to provide that we will match 100% of the first 4% of deferral contributions made by each participant up to $230,000 of eligible compensation. No excess contribution will be made for 2008.

Insurance. We also make available to all employees health insurance, dental insurance, and group life and disability insurance. Prior to the Sarbanes-Oxley Act of 2002, we provided split dollar life insurance arrangements for certain senior officers. We have subsequently terminated our obligations to pay future premiums with respect to existing split-dollar life insurance arrangements.

Perquisites. We provide only limited perquisites such as company-paid parking to our NEOs. We utilize corporate aircrafts for business use in an effort to improve the efficiency of required business travel. Imputed income determined in accordance with the Internal Revenue Service requirements is reflected in an NEO s aggregate compensation for income tax purposes for any business trip on which a non-employee family member or guest accompanies the NEO. For compensation disclosure purposes, the value of such travel by non-employee family members or guests is calculated by allocating costs incurred. With respect to travel by non-employee family members or guests, this is computed by allocating direct and indirect expenses, other than depreciation, on a per hour basis. Direct and indirect expenses generally include crew compensation and expenses, fuel, oil, catering expenses, hangar, rent, insurance, landing and similar fees, and maintenance costs.

Establishing Compensation Levels

Role of the Compensation Committee. The Compensation Committee is comprised entirely of independent directors who are also non-employee directors as defined in Rule 16b-3 under the Exchange Act and independent directors as defined by New York Stock Exchange rules.

The Compensation Committee operates pursuant to a charter that sets forth the mission of the Compensation Committee and its specific goals and responsibilities. The Compensation Committee s mission is to evaluate and make recommendations to the Board regarding the compensation of the Chief Executive Officer and other of our executive officers, and their performance relative to their compensation, and to assure that they are compensated effectively in a manner consistent with the compensation philosophy discussed earlier, internal equity considerations, competitive practice, and the requirements of applicable law and the appropriate regulatory bodies. In addition, the Compensation Committee evaluates and makes recommendations to the Board regarding the compensation of the directors, including their compensation for services on Board committees.

The Compensation Committee s charter reflects these goals and responsibilities, and the Compensation Committee annually reviews and revises its charter as necessary. To assist in carrying out its responsibilities, the Compensation Committee periodically receives reports and recommendations from management and from a third-party compensation consultant that it selects and retains. The Compensation Committee may also, from time to time, consult with legal, accounting or other advisors all in accordance with the authority granted to the Compensation Committee in its charter.

Role of Management. The key members of management involved in the compensation process are the Chief Executive Officer, the Chief Operating Officer and the Director of Human Resources. Management proposes certain corporate and individual performance objectives for executive management that could be established to achieve long-term objectives of Allied Capital and used to determine total compensation, and these proposals are presented to the Compensation Committee for review and approval. Management also participates in the discussion of peer companies to be used to benchmark NEO compensation, and recommends the overall funding level for the annual cash bonus, IPA and IPB. Management s recommendations are presented to the Compensation Committee for review and approval.

Role of the Compensation Consultant. The Compensation Committee annually retains a third-party compensation consultant to assess the competitiveness of the current and proposed compensation levels of our NEOs in light of competitive market practices. The Compensation Committee has engaged Ernst & Young LLP s Performance and Reward Practice or its predecessor (the Compensation Consultant) for this purpose for more than five years.

The Compensation Consultant attends Compensation Committee meetings, meets with the Compensation Committee without management present and provides third-party data, advice and expertise on current and proposed executive and director compensation. At the direction of the Compensation Committee, the Compensation Consultant prepares an analysis of compensation matters including positioning of programs in the competitive market, including peer group review, and the design of plans consistent with the Compensation Committee s compensation philosophy.

Ernst & Young, LLP provides consulting and other services to us, however, the Compensation Committee believes this does not compromise the Compensation Consultant s ability to provide an independent perspective on executive compensation. During 2007, the Compensation Consultant was paid $128,689 for its services to the Compensation Committee.

Assessment of Market Data, Peer Comparisons and Benchmarking of Compensation. The Compensation Consultant assists the Compensation Committee with the assessment of the compensation practices of comparable companies. Given our structure as a publicly traded, internally managed BDC coupled with the fact that most of our direct competitors are privately held private equity partnerships, specific compensation information with respect to our direct competitors typically is not publicly available. There are a limited number of published survey sources that have a primary focus on the private equity industry and that provide annualized information on long-term incentive plans in the industry, which typically take the form of carried interest.

As a part of the annual assessment of compensation, the Compensation Committee and the Compensation Consultant analyze NEO compensation information relative to:

- a peer group of publicly traded companies, as determined by the Compensation Committee, including internally managed BDCs, deemed similar to Allied Capital in terms of industry segment, company size and competitive industry and geographic market for executive talent;

- published survey data on similarly sized private equity firms; and

- an estimation of aggregate compensation levels paid by externally managed publicly traded BDCs and similar pass-through structures, such as real estate investment trusts.

Through this process, the Compensation Committee benchmarks our compensation for NEOs, including the CEO, to the median (50th percentile) through the 75th percentile of competitive market data. However, the Compensation Committee is unable to benchmark the compensation data of individual NEOs from the externally managed companies because no individual compensation data is available.

Our peer group is the same peer group used for our 2006 analysis and is composed of the following nine publicly traded companies in the financial services industry:

- AllianceBernstein Holding L.P.
- American Capital Strategies, Ltd.
- CapitalSource Inc.
- CIT Group Inc.
- Federated Investors, Inc.
- Friedman, Billings, Ramsey Group, Inc.
- iStar Financial, Inc.
- Legg Mason, Inc.
- T. Rowe Price Group, Inc.

While comparisons to compensation levels at our peer group is helpful in assessing the overall competitiveness of our executive compensation program, we believe that our executive compensation program also must be internally consistent and equitable in order for us to achieve our investment objectives and to continue to attract and retain outstanding employees.

The Compensation Committee uses the private equity published survey data to assess the market for investment professionals, but also considers each individual s contribution to Allied Capital that year to assess internal pay equity.

As a result, the composition of our NEOs, excluding the Chief Executive Officer and the Chief Financial Officer, may change from year to year.

Review of Tally Sheets. The Compensation Committee annually reviews tally sheets that illustrate all components of the compensation provided to our NEOs, including base salary, annual cash bonus, IPAs and IPBs, stock option awards, perquisites and benefits and the accumulated balance under non-qualified deferred compensation plans. Furthermore, the Compensation Committee annually reviews tally sheets prepared by the Compensation Consultant that illustrate the aggregate amounts that may be paid as the result of certain events of termination under employment agreements including a change of control for Mr. Walton and Mmes. Sweeney and Roll. The purpose of these tally sheets is to bring together, in one place, all of the elements of actual and potential future compensation for our executives who have employment agreements, as well as information about wealth accumulation, so that the Compensation Committee may analyze both the individual elements of compensation as well as the aggregate total amount of actual and projected compensation. The Compensation Committee also provides a full report of all compensation program components to the Board of Directors, including the review and discussion of the tally sheets.

Assessment of Corporate and Individual Performance. The Compensation Committee considered certain corporate and individual performance measures that have been established to achieve long-term total return to stockholders. The corporate and individual performance measures for 2007 included, among others, the following:

Setting strategic direction;

Maintaining the highest ethical standards, internal controls and adherence to regulatory requirements;

Maintaining appropriate dividend payouts to shareholders with the appropriate balance of interest and fee income and capital gain harvest;

Maintaining a conservative balance sheet and investment grade status;

Continually innovating and improving the Company s investment process;

Maintaining portfolio credit quality and improving overall portfolio performance;

Continually innovating and improving financial and operating services provided to portfolio companies; and

Attracting and retaining the best and brightest talent, developing potential successors for future leadership roles.

During 2007, we achieved numerous strategic investment and operational goals and objectives, including, among other things:

Invested $1.8 billion;

Generated $268.5 million in net realized capital gains;

Paid $407.3 million in dividends to stockholders, a 7% increase in dividends per share over 2006;

Established the Allied Capital Senior Debt Fund, L.P. with an initial closing of $125 million in equity capital commitments; and

Partnered with GE Commercial Finance to establish the $3.6 billion Unitranche Fund LLC.

Compensation Determination

In identifying prevailing market competitive compensation and benefit levels for similarly situated companies, Allied Capital employs the three-pronged approach discussed above. In determining the individual compensation for our NEOs, the Compensation Committee considers the total compensation to be awarded to each NEO and may exercise discretion in determining the portion allocated to the various components of total compensation and there is no pre-determined weighting of any specific components. We believe that the focus on total compensation provides the ability to align pay decisions with short- and long-term needs of the business. This approach also allows for the flexibility needed to recognize differences in performance by providing differentiated pay.

Individual compensation levels for NEOs are determined based on individual performance and the achievement of certain corporate and executive performance objectives that have been established to achieve our long-term objectives. Increases to base salary are awarded to recognize an executive for assuming additional responsibilities and his/her related performance, to address changes in the external competitive market for a given position, or to achieve an appropriate competitive level due to a promotion to a more senior position.

In determining the amount of an executive s variable compensation the annual cash bonus, IPA and IPB the Compensation Committee uses market-based total compensation guidelines described above, which are the proxy peer group analysis, private equity published survey data, and estimates of and comparisons to compensation paid by externally managed publicly traded pass-through companies. Within those guidelines, the Compensation Committee considers the overall funding available for such awards, the executive s performance, and the desired mix between the various components of total compensation. We do not use a formula-based approach in determining individual awards or weighting between the components. Rather, discretion is exercised in determining the overall total compensation to be awarded to the executive. As a result, the amounts delivered in the form of an annual cash bonus, IPA and IPB are designed to work together in conjunction with base salary to deliver an appropriate total compensation level to the NEO.

We believe that the discretionary design of our variable compensation program supports our overall compensation objectives by allowing for significant differentiation of pay based on individual performance and by providing the flexibility necessary to ensure that pay packages for our NEOs are competitive relative to our market.

Determination of 2007 Compensation for the CEO and other NEOs. The compensation of our Chief Executive Officer and other NEOs is determined based on the achievement of certain corporate and individual performance objectives discussed above. 2007 was a year of continued progress in achieving the objectives that contribute to the long-term success of Allied Capital. Among other things described above, we invested $1.8 billion, generated $268.5 million in net realized gains, and paid $407.3 million in dividends to stockholders. The Compensation Committee acknowledged the fact that, while management had achieved numerous strategic investment and operational goals and objectives for the year, market conditions had resulted in a significant reduction in our stock price during the latter half of 2007, which adversely affected total return to stockholders for the year.

Mr. Walton is paid an annual base salary of $1,500,000, the same rate that has been in effect since February 2004. Mr. Walton received an annual bonus for 2007 of $2,150,000, a 22% reduction from the annual bonus that was paid for 2006. Mr. Walton also received a 2007 IPA of $1,475,000 and a 2007 IPB of $1,475,000, which were the same amounts as the prior year. Mr. Walton received a grant of 186,000 stock options in 2007; he did not receive a stock option grant in 2006.

Ms. Sweeney is paid an annual base salary of $1,000,000, the same rate that has been in effect since February 2004. Ms. Sweeney received an annual bonus for 2007 of $1,300,000, a 13% reduction from the annual bonus that was paid for 2006. Ms. Sweeney also received a 2007 IPA of $750,000 and a 2007 IPB of $750,000, which were the same amounts as the prior year. Ms. Sweeney received a grant of 139,500 stock options in 2007; she did not receive a stock option grant in 2006.

For 2007, Ms. Roll was paid an annual base salary of $525,000, the same rate that has been in effect since 2006. Ms. Roll received an annual bonus for 2007 of $850,000, the same annual bonus that she received in 2006, in recognition of Allied Capital s performance and her individual performance. Ms. Roll also received a 2007 IPA of $350,000 and a 2007 IPB of $350,000. Ms. Roll received a grant of 139,500 stock options in 2007.

For 2007, Mr. Russell was paid an annual base salary of $550,000. Mr. Russell received an annual bonus for 2007 of $2,475,000 in recognition of Allied Capital s performance and his individual performance. Mr. Russell also received a 2007 IPA of $475,000 and a 2007 IPB of $475,000. Mr. Russell received a grant of 186,000 stock options in 2007.

For 2007, Mr. Scheurer was paid an annual base salary of $600,000. Mr. Scheurer received an annual bonus for 2007 of $1,700,000 in recognition of Allied Capital s performance and his individual performance. Mr. Scheurer also received a 2007 IPA of $550,000 and a 2007 IPB of $550,000. Mr. Scheurer received a grant of 139,500 stock options in 2007.

After reviewing the 2007 peer group information, tally sheets and the achievement of corporate and executive performance measures for each of these executives, the Compensation Committee determined that the total compensation levels for each of these executives was within a competitive range to existing market levels and remained consistent with the Compensation Committee s expectations.

Stock Option Practices

Our principal objective in awarding stock options to our officers and directors is to align each optionee s interests with the success of Allied Capital and the financial interests of our stockholders by linking a portion of such optionee s compensation with the performance of our stock and the value delivered to stockholders. The Compensation Committee awards stock options on a subjective basis and such awards depend in each case on the performance of the officer under consideration, and in the case of new hires, their potential performance. Stock options are priced at the closing price of the stock on the date the option is granted. See Amended Stock Option Plan.

Restricted Stock

In October 2007, we filed an exemptive application with the Commission to permit the issuance of restricted stock to our employees and non-officer directors. If we were to receive an order from the Commission to permit such issuance, we would be required to seek the approval of stockholders before we may issue restricted stock. Assuming we obtained stockholder approval, the Board of Directors would consider the issuance of restricted stock together with the issuance of stock options as another form of equity compensation.

Target Ownership Program

During 2006, the Board of Directors established a target ownership program to encourage share ownership by our senior officers, so that the interests of the officers and stockholders are aligned. Generally, officers have five years to achieve their target ownership level, which is determined on an individual basis by the Compensation Committee and adjusted annually to reflect increases in base salary, if any. The Compensation Committee considers these target ownership levels and each individual s progress toward achieving his or her target ownership in connection with its annual compensation review. See Target Ownership for additional information related to the target ownership program.

Impact of Regulatory Requirements Tax Deductibility of Pay

Section 162(m) of the Code places a limit of $1,000,000 on the amount of compensation that we may deduct in any one year, which applies with respect to certain of our most highly paid executive officers for 2007. There is an exception to the $1,000,000 limitation for performance-based compensation meeting certain requirements. To maintain flexibility in compensating executive officers in a manner designed to promote varying corporate goals, the Compensation Committee has not adopted a performance-based compensation policy. The total compensation for each of Messrs. Walton, Russell, Scheurer and Ms. Sweeney is above the $1,000,000 threshold for 2007; accordingly, for 2007, a portion of their total compensation, including salaries, bonuses, IPBs, and other compensation is not deductible by us.

Summary Compensation

The following table sets forth compensation paid to our principal executive officer, principal financial officer and each of our three highest paid executive officers (collectively, the Named Executive Officers or NEOs) in each capacity in which each NEO served. Certain of the NEOs served as both officers and directors.

Name and Principal Position	Year	Salary	Bonus[1]	Stock Awards	Option Awards[2]	Non-Equity Incentive Plan Compensation	Change in Pension Value and Non-Qualified Deferred Compensation Earnings[3]	All Other Compensation[4]	Total
William L. Walton, Chief Executive Officer	2007	$ 1,505,769	$ 5,301,250	n/a	$ 488,229	n/a	n/a	$ 3,658,402	$ 10,953,650
	2006	1,500,000	5,700,000	n/a	421,142	n/a	n/a	250,763	7,871,905
Joan M. Sweeney, Chief Operating Officer	2007	$ 1,003,846	$ 2,913,750	n/a	$ 366,172	n/a	n/a	$ 1,986,159	$ 6,269,927
	2006	1,000,000	3,000,000	n/a	314,827	n/a	n/a	134,418	4,449,245
Penni F. Roll, Chief Financial Officer	2007	$ 527,019	$ 1,607,500	n/a	$ 576,854	n/a	n/a	$ 509,089	$ 3,220,462
	2006	523,558	1,550,000	n/a	490,659	n/a	n/a	70,571	2,634,788
Daniel L. Russell, Managing Director	2007	$ 550,673	$ 3,506,154	n/a	$ 725,172	n/a	n/a	$ 372,028	$ 5,154,027
John M. Scheurer, Managing Director	2007	$ 602,308	$ 2,868,750	n/a	$ 352,941	n/a	n/a	$ 1,308,357	$ 5,132,356

(1) This column includes annual cash bonus, IPA, IPB and for 2007 the excess 401(k) Plan contribution, which represents the excess amount of the 5% employer contribution over the IRS limit of how much an employer may contribute to the 401(k) plan which was paid in cash for 2007. For 2006, this excess contribution was contributed to the 2005 DCP I. For a discussion of these compensation components, see Compensation Discussion and Analysis above. The following table provides detail as to the composition of the bonus received by each of the NEOs:

Excess 401(k)

	Year	Bonus	IPA	IPB	Contribution
Mr. Walton	2007	$ 2,150,000	$ 1,475,000	$ 1,475,000	$ 201,250
	2006	$ 2,750,000	$ 1,475,000	$ 1,475,000	
Ms. Sweeney	2007	$ 1,300,000	$ 750,000	$ 750,000	$ 113,750
	2006	$ 1,500,000	$ 750,000	$ 750,000	
Ms. Roll	2007	$ 850,000	$ 350,000	$ 350,000	$ 57,500
	2006	$ 850,000	$ 350,000	$ 350,000	
Mr. Russell	2007	$ 2,475,000	$ 475,000	$ 475,000	$ 81,154
Mr. Scheurer	2007	$ 1,700,000	$ 550,000	$ 550,000	$ 68,750

(2) The following table sets forth the amount included in the Option Awards column with respect to prior year awards and the 2007 awards. See Note 2 to our 2007 consolidated financial statements for the assumptions used in determining SFAS 123R values. See the Grants of Plan-Based Awards table for the full fair value of the options granted to NEOs in 2007. The amount recognized for financial statement reporting purposes represents the SFAS 123R fair value of options awarded in prior and current years that vested in 2007, which are non-cash expenses.

	SFAS 123R Expenses Included in the Table Attributed to:	
2007 Non-Cash Expense for Option Awards	**Prior-Year Awards**	**2007 Awards**
Mr. Walton	$ 210,882	$ 277,347
Ms. Sweeney	$ 158,162	$ 208,010
Ms. Roll	$ 368,844	$ 208,010
Mr. Russell	$ 447,826	$ 277,346
Mr. Scheurer	$ 144,931	$ 208,010

(3) There were no above market or preferential earnings on the non-qualified deferred compensation plans. See Non-Qualified Deferred Compensation below.

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(4) All Other Compensation is composed of the following:

	Year	Company Contribution to 401(k) Plan	Employer Contribution to 2005 DCP I(A)	SFAS 123R Expense Related to the OCP(B)	Other(C)
Mr. Walton	2007	$ 11,250		$ 3,612,697	$ 34,455
	2006	$ 11,000	$ 201,500	n/a	$ 38,263
Ms. Sweeney	2007	$ 11,250		$ 1,966,137	$ 8,772
	2006	$ 11,000	$ 114,000	n/a	$ 9,418
Ms. Roll	2007	$ 11,250		$ 493,223	$ 4,616
	2006	$ 11,000	$ 55,154	n/a	$ 4,417
Mr. Russell	2007	$ 11,250		$ 356,667	$ 4,111
Mr. Scheurer	2007	$ 11,250		$ 1,287,492	$ 9,615

(A) Because the IRS limits the amount an employer may contribute to a 401(k) plan on behalf of each participant, for 2006 we contributed the excess amount of the 5% employer contribution over this limit to the 2005 DCP I on behalf of the participant. For 2007, this excess contribution was paid in cash to the participant and is included as a bonus in 2007.

(B) Because the weighted average market price of our common stock at the commencement of the tender offer was higher than the market price at the close of the tender offer, SFAS 123R required the Company to record stock option expense related to the stock options cancelled. This is a non-cash expense deemed to be compensation for financial reporting purposes.

(C) This amount includes perquisites such as company-paid parking and the imputed income value of split dollar life insurance arrangements. For Messrs. Walton and Scheurer, the amount also includes the premiums associated with executive long-term disability insurance. In addition, the amount includes $23,994 for Mr. Walton and $2,370 for Ms. Sweeney, and $1,241 for Mr. Russell related to the allocated costs associated with the travel of non- employee family members or guests when they have accompanied the NEOs on trips for business purposes. The value of this perquisite is different than each NEO s imputed income, which is calculated in accordance with IRS requirements.

Employment Agreements

We entered into employment agreements in 2004 with William L. Walton, our Chairman and CEO, Joan M. Sweeney, our Chief Operating Officer, and Penni F. Roll, our Chief Financial Officer. These agreements were amended in 2007 to comply with Section 409A of the Code and to address other tax-related matters. Each of the agreements provides for a three-year term that extends one day at the end of every day during its length, unless either party provides written notice of termination of such extension. In that case, the agreement would terminate three years from such notification.

Each agreement specifies each executive s base salary compensation during the term of the agreement. The Compensation Committee has the right to increase the base salary during the term of the employment agreement. In addition, each employment agreement states that the Compensation Committee may provide, at their sole discretion, an annual cash bonus. This bonus is to be determined with reference to each executive s performance in accordance with performance criteria to be determined by the Compensation Committee in its sole discretion. Under each agreement, each executive is also entitled to participate in our Amended Stock Option Plan, and to receive all other awards and benefits previously granted to each executive including, the payment of life insurance premiums.

The executive has the right to voluntarily terminate employment at any time with 30 days notice, and in such case, the employee will not receive any severance pay. Among other things, the employment agreements prohibit the solicitation of employees from us in the event of an executive s departure for a period of two years. See Severance and

Change in Control Arrangements for a discussion of the severance and change in control arrangements set forth in each of these agreements.

In connection with Ms. Sweeney s planned retirement at the end of 2008, we expect to enter into a consulting agreement with Ms. Sweeney.

Grants of Plan-Based Awards

		Estimated Future Payouts Under Non-Equity Incentive Plan Awards			Estimated Future Payouts Under Equity Incentive Plan Awards			All Other Stock Awards; Number of Shares of Stock or	All Other Option Awards; Number of Securities Underlying	Exercise or Base Price of Option	Grant Date Fair Value of Stock and Option
Name	**Grant Date**	**Threshold**	**Target**	**Maximum**	**Threshold**	**Target**	**Maximum**	**Units**	**Options[1]**	**Awards**	**Awards**
William L. Walton	5/15/07								186,000	$ 29.58	$ 553,685
Joan M. Sweeney	5/15/07								139,500	29.58	415,264
Penni F. Roll	5/15/07								139,500	29.58	415,264
Daniel L. Russell	5/15/07								186,000	29.58	553,685
John M. Scheurer	5/15/07								139,500	29.58	415,264

[1] The options granted in 2007 vest in three installments on 6/30/07, 6/30/08, and 6/30/09.

Amended Stock Option Plan

Our Amended Stock Option Plan is intended to encourage stock ownership in Allied Capital by our officers and directors, thus giving them a proprietary interest in our performance, to reward outstanding performance, and to provide a means to attract and retain persons of outstanding ability to the service of Allied Capital. The Amended Stock Option Plan was most recently approved by our stockholders on May 15, 2007. At March 31, 2008, there were 37.2 million shares authorized for issuance under the Amended Stock Option Plan.

As discussed in the Compensation Discussion and Analysis, our Compensation Committee believes that stock-based incentive compensation is a key element of officer and director compensation. The Compensation Committee s principal objective in awarding stock options to our eligible officers is to align each optionee s interests with our success and the financial interests of our stockholders by linking a portion of such optionee s compensation with the performance of our stock and the value delivered to stockholders.

Stock options are granted under the Amended Stock Option Plan at a price not less than the prevailing market value at the grant date and will have realizable value only if our stock price increases. The Compensation Committee determines the amount and features of the stock options, if any, to be awarded to optionees. The Compensation Committee evaluates a number of criteria, including the past service of each such optionee to Allied Capital, the present and potential contributions of such optionee to the success of Allied Capital, and such other factors as the Compensation Committee shall deem relevant in connection with accomplishing the purposes of the Amended Stock Option Plan, including the recipient s current stock holdings, years of service, position with Allied Capital, and other factors. The Compensation Committee does not apply a formula assigning specific weights to any of these factors when making its determination. The Compensation Committee awards stock options on a subjective basis and such awards depend in each case on the performance of the officer under consideration, and in the case of new hires, their potential performance. Pursuant to the 1940 Act, options may not be repriced for any participant.

All rights to exercise options terminate 60 days after an optionee ceases to be (i) a non-officer director, (ii) both an officer and a director, if such optionee serves in both capacities, or (iii) an officer (if such officer is not also a director) for any reason other than death or total and permanent disability. If an optionee s employment is terminated for any reason other than death or total and permanent disability before expiration of his option and before he has fully exercised it, the optionee has the right to exercise the option during the balance of a 60-day period from the date of termination. If an optionee dies or becomes totally and permanently disabled before expiration of the option without fully exercising it, he or she or the executors or administrators or legatees or distributees of the estate shall, as may be provided at the time of the grant, have the right, within one year after the optionee s death or total and permanent disability, to exercise the option in whole or in part before the expiration of its term.

All outstanding options will become fully vested and exercisable upon a Change of Control. For purposes of the Option Plan, a Change of Control means (i) the sale or other disposition of all or substantially all of our assets; or (ii) the acquisition, whether directly, indirectly, beneficially (within the meaning of Rule 13d-3 of the Exchange Act), or of record, as a result of a merger, consolidation or otherwise, of securities of the Company representing fifteen percent (15%) or more of the aggregate voting power of the Company s then outstanding common stock by any person (within the meaning of Section 13(d) and 14(d) of the Exchange Act), including, but not limited to, any corporation or group of persons acting in concert, other than (A) us or our subsidiaries and/or (B) any employee pension benefit plan (within the meaning of Section 3(2) of the Employee Retirement Income Security Act of 1974) of us or our subsidiaries, including a trust established pursuant to any such plan; or (iii) the individuals who were members of the Board of Directors as of the Effective Date (the Incumbent Board) cease to constitute at least two-thirds (2/3) of the Board of Directors; provided, however, that any director appointed by at least two-thirds (2/3) of the then Incumbent Board or nominated by at least two-thirds (2/3) of the Corporate Governance/ Nominating Committee of the Board of Directors (a majority of the members of the Corporate Governance/ Nominating Committee are members of the then Incumbent Board or appointees thereof), other than any director appointed or nominated in connection with, or as a result of, a threatened or actual proxy or control contest, shall be deemed to constitute a member of the Incumbent Board.

The Amended Stock Option Plan is designed to satisfy the conditions of Section 422 of the Code so that options granted under the Amended Stock Option Plan may qualify as incentive stock options. To qualify as incentive stock options, options may not become exercisable for the first time in any year if the number of incentive options first exercisable in that year multiplied by the exercise price exceeds $100,000.

On February 1, 2008, options to purchase 7.1 million shares were granted with an exercise price of $22.96 per share. The options vest ratably over a three year period beginning on June 30, 2009. The estimated expense included in the Grants of Plan Based Awards table, above, does not include any expense related to the options granted in 2008.

We have received approval from the SEC to grant non-qualified options under the Amended Stock Option Plan to non-officer directors. Pursuant to the SEC order, non-officer directors receive options to purchase 10,000 shares upon election by stockholders to the Board of Directors, and options to purchase 5,000 shares each year thereafter, on the date of the Annual Meeting of Stockholders.

Outstanding Equity Awards at Fiscal Year-End

The following table sets forth the stock option awards outstanding at December 31, 2007:

	Option Awards[1]					Stock Awards[3]			
Name	**Number of Securities Underlying Unexercised Options Exercisable[2]**	**Number of Securities Underlying Unexercised Options Unexercisable**	**Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Unearned Options**	**Option Exercise Price**	**Option Expiration Date**	**Number of Shares or Units of Stock That Have Not Vested**	**Market Value of Shares or Units of Stock That Have Not Vested**	**Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested**	**Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units of Other Rights That Have Not Vested**
William L. Walton	400,000			$ 28.98	3/11/2014	n/a	n/a	n/a	n/a
	62,000	124,000(4)		$ 29.58	5/15/2014	n/a	n/a	n/a	n/a
Joan M. Sweeney	5,633			$ 17.75	12/30/2009	n/a	n/a	n/a	n/a
	4,646			$ 21.52	12/13/2012	n/a	n/a	n/a	n/a
	78,450			$ 28.98	3/11/2014	n/a	n/a	n/a	n/a
	46,500	93,000(4)		$ 29.58	5/15/2014	n/a	n/a	n/a	n/a
Penni F. Roll	122,677			$ 21.52	12/13/2012	n/a	n/a	n/a	n/a
	200,000			$ 28.98	3/11/2014	n/a	n/a	n/a	n/a
	133,334	66,666(5)		$ 27.51	8/3/2015	n/a	n/a	n/a	n/a
	46,500	93,000(4)		$ 29.58	5/15/2014	n/a	n/a	n/a	n/a
Daniel L. Russell	4,085			$ 21.59	9/20/2011	n/a	n/a	n/a	n/a
	4,646			$ 21.52	12/13/2012	n/a	n/a	n/a	n/a
	100,000			$ 28.98	3/11/2014	n/a	n/a	n/a	n/a
	200,000	100,000(5)		$ 27.51	8/3/2015	n/a	n/a	n/a	n/a
	62,000	124,000(4)		$ 29.58	5/15/2014	n/a	n/a	n/a	n/a
John M. Scheurer	150,000			$ 28.98	3/11/2014	n/a	n/a	n/a	n/a

	33,334	16,666(5)	$ 27.51	8/3/2015	n/a	n/a	n/a	n/a
	46,500	93,000(4)	$ 29.58	5/15/2014	n/a	n/a	n/a	n/a

(1) During 2007, we completed a tender offer for vested in-the-money options and cancelled a total of 10.3 million options.

(2) No stock option awards have been transferred.

(3) We have not made any stock awards. As a business development company, we are prohibited by the 1940 Act from issuing stock awards except pursuant to a Commission exemptive order. We have filed an application seeking exemptive relief to issue restricted stock.

(4) The options granted vest in three installments on 6/30/07, 6/30/08, and 6/30/09.

(5) The options granted vest in three installments on 6/30/06, 6/30/07, and 6/30/08.

Option Exercises and Stock Vested

No stock option awards were exercised by any NEO during the year ended December 31, 2007.

		Option Awards		Stock Awards	
Name	**Year**	**Number of Shares Acquired on Exercise**	**Value Realized on Exercise**	**Number of Shares Acquired on Vesting**	**Value Realized on Vesting**
William L. Walton	2007			n/a	n/a
Joan M. Sweeney	2007			n/a	n/a
Penni F. Roll	2007			n/a	n/a
Daniel L. Russell	2007			n/a	n/a
John M. Scheurer	2007			n/a	n/a

Option Cancellation and the OCP

In connection with our 2006 Annual Meeting of Stockholders, the stockholders approved the issuance of up to 2,500,000 shares of our common stock in exchange for the cancellation of vested in-the-money stock options granted to certain officers and directors under the Amended Stock Option Plan. Under the initiative, which was reviewed and approved by our Board of Directors, all optionees who held vested stock options with exercise prices below the market value of the stock (or in-the-money options), were offered the opportunity to receive cash and unregistered common stock in exchange for their voluntary cancellation of their vested stock options. The sum of the cash and common stock to be received by each optionee would equal the in-the-money value of the stock option cancelled. On July 18, 2007, we completed a tender offer to all optionees who held vested in-the-money stock options as of June 20, 2007. We accepted for cancellation 10.3 million vested options held by employees and non-officer directors, which in the aggregate had a weighted average exercise price per share of $21.50. This resulted in a total OCP of approximately $105.6 million, of which $52.8 million was paid in cash to satisfy required tax liabilities and $52.8 million was paid through the issuance of 1.7 million unregistered shares of our common stock, determined using the Weighted Average Market Price of $31.75, which represented the volume-weighted average price of our common stock over the fifteen trading days preceding the first day the offer period. The NEOs received the following OCPs in connection with their participation in the tender offer:

	Shares	Cash
William L. Walton	455,211	$ 14,452,966
Joan S. Sweeney	247,864	7,869,699
Penni F. Roll	59,855	1,900,424
Daniel L. Russell	38,274	1,215,205
John M. Scheurer	138,099	4,384,674

Non-Qualified Deferred Compensation

Name	Executive Contributions in 2007(1)(4)	Company Contributions in 2007(2)(4)	Aggregate Earnings in 2007(3)	Aggregate Withdrawals/ Distributions in 2007	Aggregate Balance at December 31, 2007(5)
William L. Walton	$ 1,453,612	$ 198,578	$ (2,313,904)	$	$ 11,366,271
Joan M. Sweeney	$ 739,125	$ 112,347	$ (1,092,826)	$	$ 5,832,948
Penni F. Roll	$ 344,925	$ 54,354	$ (409,013)	$	$ 2,247,601
Daniel L. Russell	$ 468,112	$ 64,020	$ (271,709)	$	$ 1,693,936
John M. Scheurer	$ 542,025	$ 60,608	$ (789,761)	$	$ 5,697,511

(1) Executive contributions are based on the IPAs earned during the 2007 plan year (net of FICA tax) and contributed to the 2005 DCP II. There are no other executive deferrals.

(2) Our contributions (net of FICA tax) are based on the excess 401(k) employer contribution made to the 2005 DCP I in 2007 (for the 2006 plan year) and allocated to the participant s account.

(3) Includes interest and dividend income and realized and unrealized gains and losses on all deferred compensation arrangements.

(4) Executive and company contributions are also reflected in the Summary Compensation Table.

(5) During 2007, our Board of Directors determined to terminate our deferred compensation arrangements, and the balances will be distributed to the participants in 2008. See Termination of Deferred Compensation Arrangements below.

The 2005 Deferred Compensation Plan I

The 2005 Allied Capital Corporation Non-Qualified Deferred Compensation Plan (2005 DCP I) is an unfunded plan, as defined in the Code, that provides for the voluntary deferral of compensation by our directors, employees, and consultants. Prior to 2005, such voluntary deferrals were made to the Allied Capital Corporation Non-Qualified Deferred Compensation Plan (DCP I). Any director, senior officer, or consultant is eligible to participate in the 2005 DCP I at such time and for such period as designated by the Board of Directors. The 2005 DCP I is administered through a grantor trust, and we fund this plan through cash contributions.

The 2005 Deferred Compensation Plan II

The 2005 Allied Capital Corporation Non-Qualified Deferred Compensation Plan II (2005 DCP II) is an unfunded plan, as defined in the Code, that provides for the deferral of compensation by our officers. All IPA contributions made for 2005, 2006, and 2007 were made into the 2005 DCP II. Prior to 2005, IPA contributions were made to the Allied Capital Corporation Non-Qualified Deferred Compensation Plan II (DCP II).

The IPAs were generally deposited in the trust in equal installments, on a quarterly basis, in the form of cash. The Compensation Committee designed both DCP II and 2005 DCP II to require the trustee to use the cash to purchase shares of our common stock in the market. A participant only vests in the award as it is deposited into the trust. The Compensation Committee, in its sole discretion, designates the senior officers who were to receive IPAs and participate in 2005 DCP II. During any period of time in which a participant had an account in either DCP II or 2005 DCP II, any dividends declared and paid on shares of common stock allocated to the participant s accounts were reinvested in shares of our common stock.

The Compensation Committee of our Board of Directors administers all of our deferred compensation arrangements. The Board of Directors reserves the right to amend, terminate, or discontinue DCP II and 2005 DCP II, provided that no such action will adversely affect a participant s rights under the plans with respect to the amounts contributed to his or her deferral accounts.

Termination of Deferred Compensation Arrangements. In December 2007, our Board of Directors made a determination that it is in our best interests to terminate our deferred compensation arrangements (each individually a Plan, or collectively, the Plans). The Board of Directors decision was primarily in response to increased complexity resulting from recent changes in the regulation of deferred compensation arrangements.

The Board of Directors resolved that DCP I and DCP II would be terminated in accordance with the provisions of each of these Plans, and the accounts under these Plans would be distributed to participants in full on March 18, 2008, the termination and distribution date, or as soon as is reasonably practicable thereafter.

The Board of Directors also resolved to amend and restate 2005 DCP I and 2005 DCP II to provide for termination of each of these Plans and distribution of the accounts under these Plans on March 18, 2008, or as soon as is reasonably practicable thereafter, in full in accordance with the transition rule for payment elections under Section 409A of the Code.

Distributions from the Plans would be made in cash or shares of our common stock, net of required withholding taxes. The assets of the rabbi trust related to DCP I and 2005 DCP I were primarily invested in assets other than shares of our common stock. At December 31, 2007, the liability to participants related to DCP I and 2005 DCP I was valued at $21.1 million in the aggregate, and that liability was fully funded by assets held in the rabbi trust.

The assets of the rabbi trust related to DCP II and 2005 DCP II were primarily invested in shares of our common stock. At December 31, 2007, the liability to participants related to DCP II and 2005 DCP II was valued at $31.4 million in the aggregate, and that liability was fully funded by assets held in the rabbi trust. At December 31, 2007, the rabbi trust held approximately 1.4 million shares for DCP II and 2005 DCP II.

The account balances in the Plans reflect a combination of participant elective compensation deferrals and non-elective employer contributions, including contributions related to previously earned IPAs. As of March 18, 2008, the termination and distribution date, the account balances of the NEOs related to DCP I, 2005 DCP I, DCP II and 2005 DCP II were $10.5 million for Mr. Walton, $5.3 million for Ms. Sweeney, $2.1 million for Ms. Roll, $1.5 million for Mr. Russell, and $5.2 million for Mr. Scheurer. The balances on the termination date were distributed in March 2008 subsequent to the termination date, in accordance with the transition rule for payment elections under Section 409A of the Code. Distributions from the plans were made in cash or shares of our common stock, net of required withholding taxes.

Changes in Method of Payment of IPA for 2008. As a result of the termination of our deferred compensation arrangements, the Compensation Committee is considering our compensation structure and other changes that may be implemented if we obtain Commission and stockholder approval to issue restricted stock. For 2008, the Compensation Committee has determined that the IPAs will be paid in cash in two equal installments during the year to eligible officers, rather than contributed to a deferred compensation plan and invested in shares of our common stock.

The total of 2008 IPAs and IPBs are estimated to be $19.2 million. The 2008 IPAs for the named executive officers are: Mr. Walton $1,475,000; Ms. Sweeney $850,000; Ms. Roll $350,000; Mr. Russell $475,000; and Mr. Scheurer $550,000. The 2008 IPBs for the named executive officers are: Mr. Walton $1,475,000; Ms. Sweeney $850,000; Ms. Roll $350,000; Mr. Russell $475,000; and Mr. Scheurer $550,000.

Severance and Change in Control Arrangements

We entered into employment agreements in 2004 with William L. Walton, Chairman and CEO, Joan M. Sweeney, Chief Operating Officer, and Penni F. Roll, Chief Financial Officer. These agreements were reviewed in 2007 and amended to comply with Section 409A and to address other tax-related matters. Each of the agreements provides for a three-year term that extends one day at the end of every day during its length, unless either party provides written notice of termination of such extension. In that case, the agreement would terminate three years from such notification. The following tables quantify the potential payments and benefits upon termination for each of the NEOs with an employment agreement, assuming the NEO s employment terminated on December 31, 2007, given the NEO s compensation and service level as of that date, excluding $11,366,271 for Mr. Walton, $5,832,948 for Ms. Sweeney and $2,247,601 for Ms. Roll representing each NEO s current deferred compensation balances, which will be distributed to each NEO in 2008 pursuant to the Board of Director s determination in December 2007 to terminate our deferred compensation arrangements. Due to the number of factors that affect these calculations, including the price of our common stock, any actual amounts paid or distributed may be different.

	Termination Scenarios		
	By Executive For Good Reason or By Company Without Cause	**Death or Disability**	**Change of Control**
William L. Walton			
Cash Payments	$ 15,633,023	$ 7,228,000	$ 15,633,023
Accelerated Vesting of Option Awards			0
Continued Benefits	206,769	206,769	206,769
Tax Equalization Payment			6,733,465
Total	$ 15,839,792	$ 7,434,769	$ 22,573,257

	Termination Scenarios		
	By Executive For Good Reason or By Company Without Cause	**Death or Disability**	**Change of Control**
Joan M. Sweeney			
Cash Payments	$ 10,324,067	$ 5,264,333	$ 10,324,067
Accelerated Vesting of Option Awards			0
Continued Benefits	152,268	152,268	152,268
Tax Equalization Payment			4,266,217

Total	$ 10,476,335	$ 5,416,601	$ 14,742,552

	Termination Scenarios		
	By Executive For Good Reason or By Company Without Cause	**Death or Disability**	**Change of Control**
Penni F. Roll			
Cash Payments	$ 5,665,983	$ 2,850,000	$ 5,665,983
Accelerated Vesting of Option Awards			0
Continued Benefits	104,149	104,149	104,149
Tax Equalization Payment			2,472,084
Total	$ 5,770,132	$ 2,954,149	$ 8,242,216

By Executive For Good Reason or By Company Without Cause. Pursuant to each of those agreements, if the executive resigns without good reason or his/her employment is terminated with cause, the executive will not receive any severance pay. If, however, employment is terminated by us without cause or by the executive for good reason, the executive will be entitled to severance pay for a period not to exceed 36 months. Severance pay will include three times the average base salary for the preceding three years, plus three times the average bonus compensation for the preceding three years, plus a lump sum severance amount, plus certain benefits for a period of one year. These benefits include COBRA premiums for Mr. Walton, Ms. Sweeney and Ms. Roll and their eligible family members for the maximum period of continuation coverage provided under COBRA, and also include the full cost for substantially equivalent health and dental insurance benefits for six months after such maximum continuation coverage expires at our sole expense. These benefits also include participation in our stock option plan, split-dollar life insurance plan, executive long term disability plan, and deferred compensation plan, if applicable. Severance payments will generally be paid in a lump sum no earlier than six months after separation.

Change of Control. In the event of a change of control, in addition to the severance value described above, Mr. Walton, Ms. Sweeney and Ms. Roll would each be entitled to a tax equalization payment to offset any applicable excise tax penalties imposed on the executive under Section 4999 of the Code. Under the terms of the Amended Stock Option Plan, all outstanding options will vest immediately upon a change of control.

Death or Disability. If employment is terminated as a result of death or disability (as defined in the executives employment agreements) and no notice of non-renewal has been given, the executive will be entitled to severance pay equal to one times his/her average base salary for the preceding three years, plus one times his/her average bonus compensation for the preceding three years, plus a lump sum severance amount, plus certain benefits previously described for a period of one year.

Notice of Non-Renewal. If a notice of non-renewal has been given prior to death or disability of the executive, then instead of using a one times multiple of the average base salary and average bonus compensation as described above, the severance amount that relates to base salary and bonus compensation would be calculated using the number of years remaining between the date of the executive s death or disability and the third anniversary of the notice of non-renewal, but in no event less than one year. Any severance relating to disability will be paid in a lump sum no earlier than six months after separation. Any severance relating to death will be paid in two installments: 75% of such pay will be paid at the time of separation and 25% will be paid on the first anniversary of such separation.

If the term of employment expires in accordance with the agreement after the delivery of a non-renewal notice by either party, the executive would continue to be employed for three years after the notice of non-renewal (unless otherwise terminated under the agreement). At the end of the three-year term, the executive would receive severance pay equal to one times the average base salary for the preceding three years, plus one times the average bonus compensation for the preceding three years, plus a lump sum severance amount, plus the benefits previously described. Severance payments will be paid in a lump sum no earlier than six months after separation.

If any provision of the employment agreements would cause the executive to incur any additional tax under Section 409A of the Code or any regulations or Treasury guidance promulgated thereunder, we will reform the provision in a manner that maintains, to the extent possible, the original intent of the applicable provision without violating the provisions of Section 409A of the Code. In addition, in such a situation, we will notify and consult with the executives prior to the effective date of any such change.

Indemnification Agreements

We have entered into indemnification agreements with our directors and certain of our senior officers including each of the NEOs. The indemnification agreements are intended to provide these directors and senior officers the maximum indemnification permitted under Maryland law and the 1940 Act. Each indemnification agreement provides that we shall indemnify the director or officer who is a party to the agreement (an Indemnitee), including the advancement of legal expenses, if, by reason of his or her corporate status, the Indemnitee is, or is threatened to be, made a party to or a witness in any threatened, pending, or completed proceeding, other than a proceeding by or in the right of Allied Capital.

Target Ownership

During 2006, our Board of Directors established a target ownership program, which requires senior officers to achieve and retain certain stock ownership levels commensurate with their positions at Allied Capital. From the inception of the target ownership program in 2006, officers have five years to achieve the required ownership levels. Individuals who are hired or promoted after the implementation of the target ownership program would be required to achieve the target ownership level within the later of five years from the date of hire or three years from the date of promotion to the relevant title. Many of our senior officers already own a substantial number of our shares and few have chosen to sell shares over their tenure with us. The Board of Directors believes that it is in the best interest of stockholders to encourage share ownership by our senior officers, so that the interests of officers and stockholders are aligned.

The Board of Directors has determined target ownership levels for our senior officers, as follows:

Senior Officer	**Multiple of Base Salary**	**Minimum Share Ownership Range**
Chief Executive Officer	5x	250,000 shares
Management Committee Members	4x	55,000 130,000 shares
Managing Directors and Executive Vice Presidents who are not members of the Management Committee	3x	21,500 45,000 shares
Principals	2x	10,000 20,500 shares

Target ownership amounts represent the lesser of a multiple of base salary or a specified number of shares. Minimum share ownership requirements are determined on an individual basis and are adjusted annually by the Compensation Committee.

Our Chief Executive Officer, Chief Operating Officer and Chief Financial Officer, as well as certain other senior officers, have met their target ownership levels set forth above. See Control Persons and Principal Holders of Securities.

In addition, pursuant to our Corporate Governance Policy, each non-officer director is required to own $100,000 worth of shares, and directors are required to achieve this target ownership level within five years of joining the Board or (in the case of those directors who were serving on the Board at the time the policy was adopted by the Board) by February 2011. The majority of our directors have achieved this target ownership level.

CONTROL PERSONS AND PRINCIPAL HOLDERS OF SECURITIES

As of May 6, 2008, there were no persons that owned 25% or more of our outstanding voting securities, and no person would be deemed to control us, as such term is defined in the 1940 Act.

The following table sets forth, as of May 6, 2008, each stockholder who owned more than 5% of our outstanding shares of common stock, each director, each NEO, and our directors and executive officers as a group. Unless otherwise indicated, we believe that each beneficial owner set forth in the table has sole voting and investment power. Certain shares beneficially owned by our executive officers and directors may be held in accounts with third party brokerage firms, where such shares may from time to time be subject to a security interest for margin credit provided in accordance with such brokerage firm s policies.

Our directors are divided into two groups interested directors and independent directors. Interested directors are interested persons as defined in Section 2(a)(19) of the 1940 Act.

Each director and executive officer has the same address as Allied Capital Corporation, 1919 Pennsylvania Avenue, NW, Washington, DC 20006.

Name of Beneficial Owner	Number of Shares Owned Beneficially[1]	Percentage of Class[2]	Dollar Range of Equity Securities Beneficially Owned by Directors[3]
Interested Directors:			
William L. Walton[4]	1,717,340	1.0%	over $100,000
Joan M. Sweeney[5]	919,319	*	over $100,000
Robert E. Long[6]	45,716	*	over $100,000
Independent Directors:			
Ann Torre Bates[7]	33,845	*	over $100,000
Brooks H. Browne[8]	90,236	*	over $100,000
John D. Firestone[9]	76,231	*	over $100,000
Anthony T. Garcia[10]	79,083	*	over $100,000
Edwin L. Harper[11]	11,446	*	over $100,000
Lawrence I. Hebert[12]	38,971	*	over $100,000
John I. Leahy[13]	31,637	*	over $100,000
Alex J. Pollock[14]	37,823	*	over $100,000
Marc F. Racicot[15]	6,088	*	$10,001-$50,000
Guy T. Steuart II[16]	334,924	*	over $100,000
Laura W. van Roijen[17]	82,804	*	over $100,000
Named Executive Officers:			
Penni F. Roll[18]	866,580	*	over $100,000
Daniel L. Russell[19]	616,604	*	over $100,000
John M. Scheurer[20]	833,429	*	over $100,000
All directors and executive officers as a group (32 in number)	12,441,818	7.03%	

* Less than 1%

(1) Beneficial ownership has been determined in accordance with Rule 13d-3 of the Securities Exchange Act of 1934.

(2) Based on a total of 169,691,875 shares of our common stock issued and outstanding on May 6, 2008, and 7,353,167 shares of our common stock issuable upon the exercise of stock options exercisable within 60 days

held by each executive officer and non-officer director.

(3) Beneficial ownership has been determined in accordance with Rule 16a-1(a)(2) of the Securities Exchange Act of 1934.

(4) Includes 1,172,259 shares owned directly and 524,000 options exercisable within 60 days of May 6, 2008. Also includes 9,066 shares allocated to 401(k) plan and 12,015 shares held in IRA or Keogh accounts.

(5) Includes 718,031 shares owned directly and options to purchase 181,729 shares exercisable within 60 days of May 6, 2008. Also includes 19,559 shares allocated to 401(k) plan.

(6) Includes exercisable options to purchase 25,000 shares.

(7) Includes 7,250 shares held in IRA or Keogh accounts and includes exercisable options to purchase 25,000 shares.

(8) Includes 12,280 shares held in IRA or Keogh accounts and includes exercisable options to purchase 35,000 shares.

(9) Includes 3,415 shares held in IRA or Keogh accounts and includes exercisable options to purchase 30,000 shares.

(10) Includes exercisable options to purchase 15,000 shares.

(11) Includes 5,000 shares held in a revocable trust, 1,000 shares held by spouse in a revocable trust, and includes exercisable options to purchase 5,000 shares.

(12) Includes exercisable options to purchase 15,000 shares and 9,000 shares held in a revocable trust.

(13) Includes exercisable options to purchase 5,000 shares.

(14) Includes 3,000 shares held in IRA or Keogh accounts and includes exercisable options to purchase 15,000 shares.

(15) Includes exercisable options to purchase 5,000 shares.

(16) Includes 276,691 shares held by a corporation for which Mr. Steuart serves as an executive officer, and includes exercisable options to purchase 5,000 shares.

(17) Includes 10,739 shares held in IRA or Keogh accounts and includes exercisable options to purchase 45,000 shares.

(18) Includes 236,327 shares owned directly and options to purchase 615,677 shares exercisable within 60 days of May 6, 2008. Also includes 14,576 shares allocated to 401(k) plan.

(19) Includes 83,873 shares owned directly and options to purchase 532,731 shares exercisable within 60 days of May 6, 2008.

(20) Includes 493,548 shares owned directly and options to purchase 293,000 shares exercisable within 60 days of May 6, 2008. Also includes 46,881 shares allocated to 401(k) plan.

CERTAIN RELATIONSHIPS AND RELATED PARTY TRANSACTIONS

We have procedures in place for the review, approval and monitoring of transactions involving us and certain related persons of us. As a business development company, we are prohibited by the 1940 Act from participating in transactions with any persons affiliated with the business development company, including, officers, directors, and employees of the business development company and any person controlling or under common control with the business development company, or the Affiliates, absent a Commission exemptive order.

In the ordinary course of business, we enter into transactions with portfolio companies that may be considered related party transactions. We have implemented procedures to ensure that we do not engage in any prohibited transactions with any persons affiliated with us.

In addition, our Code of Business Conduct, which is annually reviewed and approved by the Board of Directors and acknowledged in writing by all employees, requires that all employees and directors avoid any conflict, or the appearance of a conflict, between an individual s personal interests and our interests. Pursuant to the Code of Business Conduct, each employee and director must disclose any conflicts of interest, or actions or relationships that might give rise to a conflict, to the Chief Compliance Officer. In the event that either of these officers is involved in the action or relationship giving rise to the conflict of interest, the individual is directed to disclose the conflict to another member of the our senior management team. The Corporate Governance/ Nominating Committee is charged with monitoring and making recommendations to the Board of Directors regarding policies and practices relating to corporate governance. Certain actions or relationships that might give rise to a conflict of interest are reviewed and approved by the Board of Directors.

The following table sets forth certain information, as of May 6, 2008, regarding indebtedness to Allied Capital in excess of $120,000 of any person serving as a director or executive officer of Allied Capital at any time since January 1, 2007. All of such indebtedness results from loans we made to enable the exercise of stock options. The loans are required to be fully collateralized and are full recourse against the borrower and have varying terms not exceeding ten years. The interest rates charged generally reflect the applicable federal rate on the date of the loan. As of December 31, 2007, the total loans outstanding to such executive officers of Allied Capital was $2.7 million or 0.1% of Allied Capital s total assets at December 31, 2007.

As a business development company under the Investment Company Act of 1940, we are entitled to provide and have provided loans to our officers in connection with the exercise of stock options. However, as a result of provisions of the Sarbanes-Oxley Act of 2002, we have been prohibited from making new loans to our executive officers since July 30, 2002.

Name and Position with Company	**Amount of Principal Paid During 2007**	**Amount of Interest Paid During 2007**	**Highest Amount Outstanding During 2007**	**Range of Interest Rates High**	**Range of Interest Rates Low**	**Amount Outstanding at May 6, 2008**
Executive Officers:						
Kelly A. Anderson	$	$ 24,116	$ 496,225	5.96%	3.91%	$ 464,293
Michael J. Grisius	$ 24,000	$ 8,851	$ 206,727	4.68%	3.91%	$ 172,727
Penni F. Roll	$	$ 30,338	$ 531,524	4.90%	4.45%	$ 531,524
Suzanne V. Sparrow	$	$ 16,624	$ 281,213	4.98%	4.45%	$ 281,213

TAX STATUS

The following discussion is a general summary of the material United States federal income tax considerations applicable to us and to an investment in our common stock. This summary does not purport to be a complete description of the income tax considerations applicable to such an investment. The discussion is based upon the Code, Treasury Regulations, and administrative and judicial interpretations, each as of the date of this prospectus and all of which are subject to change. You should consult your own tax advisor with respect to tax considerations that pertain to your purchase of our common stock.

This summary is intended to apply to investments in our common stock and assumes that investors hold our common stock as capital assets. This summary does not discuss all aspects of federal income taxation relevant to holders of our common stock in light of particular circumstances, or to certain types of holders subject to special treatment under federal income tax laws, including dealers in securities, pension plans and trusts and financial institutions. This summary does not discuss any aspects of U.S. estate and gift tax or foreign, state or local tax. It does not discuss the special treatment under federal income tax laws that could result if we invested in tax-exempt securities or certain other investment assets.

Except as specifically indicated herein, this summary is intended to apply to U.S. Stockholders (as defined below) and does not purport to discuss all U.S. federal income tax consequences to persons who are not U.S. Stockholders (Non-U.S. Stockholders) from an investment in our common stock. (A U.S. Stockholder is a stockholder who is (i) a citizen or resident of the United States, (ii) a corporation or partnership created in or organized under the laws of the United States or any political subdivision thereof, (iii) an estate, the income of which is subject to United States federal income taxation regardless of its source, or (iv) a trust subject to the supervision of a court within the United States and the control of a United States person.) Non-U.S. Stockholders should consult their own tax advisors to discuss the consequences of an investment in our common stock.

Taxation as a Regulated Investment Company

We intend to be treated for tax purposes as a regulated investment company under Subchapter M of Chapter 1 of the Code. If we (i) qualify as a regulated investment company and (ii) distribute to stockholders in a timely manner at least 90% of our investment company taxable income, as defined in the Code (i.e., net ordinary investment income, including accrued original issue discount, and net realized short-term capital gain in excess of net realized long-term capital loss) (the 90% Distribution Requirement) each year, we generally will not be subject to federal income tax on the portion of our investment company taxable income and net capital gain (i.e., net realized long-term capital gain in excess of net realized short-term capital loss) we distribute (or treat as deemed distributed) to stockholders. In addition, we are generally required to distribute in a timely manner an amount at least equal to the sum of (i) 98% of our ordinary income for each calendar year, (ii) 98% of our capital gain net income for the one-year period ending December 31 of that calendar year, and (iii) any income realized, but not taxed or distributed in prior years, in order to avoid the 4% nondeductible federal excise tax on certain undistributed income of regulated investment companies (the Excise Tax Avoidance Requirements). If we do not satisfy the Excise Tax Avoidance Requirements for any year, we will be required to pay this 4% excise tax on the amount by which 98% of the current year s taxable income exceeds the distribution for the year. The ordinary income or net capital gain income on which the excise tax is paid is generally distributed to shareholders in the next tax year. Depending on the level of ordinary income or net capital gain income for a tax year, we may choose to carry over the portion of such income in excess of our current year distributions into the next tax year and pay the 4% excise tax, as required. We will be subject to federal income tax at the regular corporate rate on any amounts of investment company taxable income or net capital gain not distributed (or deemed distributed) to our stockholders.

In order to qualify as a regulated investment company for federal income tax purposes, we must, among other things: (a) continue to qualify as a business development company under the 1940 Act; (b) derive in each taxable year at least 90% of our gross income from (i) dividends, interest, payments with respect to securities loans, gains from the sale of stock or other securities, or other income derived with respect to our business of investing in such stock or securities or (ii) net income derived from an interest in a qualified publicly traded partnership (the 90% Income Test); and (c) diversify our holdings so that at the end of each quarter of the taxable year (i) at least 50% of the value of our assets consists of cash, cash items, U.S. government securities, securities of other regulated investment companies, and other securities if such other securities of any one issuer do not represent more than 5% of our assets or more than 10% of the outstanding voting securities of the issuer, and (ii) no more than 25% of the value of our assets is invested in the securities of any one issuer (other than U.S. government securities or securities of other regulated investment companies), the securities of two or more issuers that are controlled (as determined under applicable Code rules) by us and are engaged in the same or similar or related trades or businesses, or the securities of one or more qualified publicly traded partnerships (the Diversification Tests).

If we acquire or are deemed to have acquired debt obligations that were issued originally at a discount or that otherwise are treated under applicable tax rules as having original issue discount or market discount, we must include in income each year a portion of the original issue discount that accrues over the life of the obligation regardless of whether cash representing such income is received by us in the same taxable year. Any amount accrued as original issue discount will be included in our investment company taxable income for the year of accrual and cash or other assets equal to the amount of such original issue discount accrual may have to be distributed to our stockholders in order to satisfy the 90% Distribution Requirement or the Excise Tax Avoidance Requirements even though we have not received any cash representing such income.

To the extent we engage in certain hedging transactions, including hedging transactions in options, future contracts, and straddles, or other similar transactions, we may be subject to special tax rules (including constructive sale, mark-to-market, straddle, wash sale, and short sale rules), the effect of which may be to accelerate our income, disallow, suspend or otherwise limit our losses or deductions, cause adjustments in the holding periods of our securities, convert long-term capital gains into short-term capital gains or ordinary income, or convert short-term capital losses into long-term capital losses, or other tax consequences.

In addition, although we do not currently intend to do so, if we were to invest in certain options, futures, or forward contracts, we may be required to report income from such investments on a mark-to-market basis, which could result in us recognizing unrealized gains and losses for federal income tax purposes even though we may not realize such gains and losses when we ultimately dispose of such investments. We could also be required to treat such gains and losses as 60% long-term capital gain or loss and 40% short-term capital gain or loss regardless of our holding period for the investments.

These rules could affect our investment company taxable income or net capital gain for a taxable year and thus affect the amounts that we would be required to distribute to our stockholders pursuant to the 90% Distribution Requirement and the Excise Tax Avoidance Requirements for such year.

Although we do not presently expect to do so, we are authorized to borrow funds and to sell assets in order to satisfy distribution requirements. However, under the 1940 Act, we are not permitted to make distributions to stockholders while our debt obligations and other senior securities are outstanding unless certain asset coverage tests are met. Moreover, our ability to dispose of assets to meet our distribution requirements may be limited by the illiquid nature of our portfolio and other requirements relating to our status as a regulated investment company, including the Diversification Tests. If we dispose of assets in order to meet the 90% Distribution Requirement or the Excise Tax Avoidance Requirements, we may make such dispositions at times that, from an investment standpoint, are not advantageous.

If we fail to satisfy the 90% Distribution Requirement or fail to qualify as a regulated investment company in any taxable year, we will be subject to tax in that year on all of our taxable income, regardless of whether we make any distributions to our stockholders. In that case, all of our income will be subject to corporate-level tax, reducing the amount available for debt service and distribution to our stockholders, and our distributions to our stockholders generally will be characterized as ordinary income (to the extent of our current and accumulated earnings and profits), although such distributions may constitute qualified dividend income to individual shareholders subject to the same reduced maximum rate of tax applicable to long-term capital gains. In contrast, if we qualify as a regulated investment company, our corporate-level federal income tax should be substantially reduced or eliminated, and a portion of our distributions or deemed distributions may be characterized as long-term capital gain in the hands of our stockholders.

The remainder of this summary assumes that we qualify as a regulated investment company and satisfy the 90% Distribution Requirement.

Taxation of Stockholders

Our distributions generally are taxable to stockholders as ordinary income or capital gains. Our distributions of investment company taxable income will be taxable as ordinary income to stockholders to the extent of our current or accumulated earnings and profits, whether paid in cash or reinvested in additional common stock (including any dividends reinvested through our dividend reinvestment plan). A portion of our distributions of investment company taxable income may constitute qualified dividend income. Qualified dividend income of individual shareholders currently is subject to the same reduced maximum rate of tax applicable to long-term capital gains. Our distributions of net capital gains properly designated by us as capital gain dividends will be taxable to each stockholder as long-term capital gains regardless of the stockholder s holding period for his or her common stock and regardless of whether paid in cash or reinvested in additional common stock (including any dividends reinvested through our dividend reinvestment plan). Distributions in excess of the Company s earnings and profits will be designated as a return of capital and first will reduce a stockholder s adjusted tax basis in such stockholder s common stock and, after the adjusted basis is reduced to zero, will generally constitute capital gains to such stockholder.

At our option, we may elect to retain some or all of our net capital gains for a tax year, but designate the retained amount as a deemed distribution. In that case, among other consequences, we will pay tax on the retained amount for the benefit of our stockholders, the stockholders will be required to report their share of the deemed distribution on their tax returns as if it had been distributed to them, and the stockholders will report a credit for their share of the tax paid thereon by us. The amount of the deemed distribution net of such tax will be added to the stockholder s cost basis for his or her common stock. Since we would be required to pay tax at our regular corporate capital gain tax rate on any retained net capital gains that are deemed to be distributed, and since that rate is in excess of the maximum rate currently payable by individuals on long-term capital gains, the amount of tax that individual stockholders will be treated as having paid and for which they will receive a credit will exceed the amount of tax that such stockholders would be required to pay on the retained net capital gains. Such excess generally will be available to offset other tax liabilities of the stockholders. A stockholder that does not have a sufficient amount of other tax liabilities or that is not subject to U.S. federal income tax should be able to file a return on the appropriate form or a claim for refund that allows such stockholder to recover the taxes paid on his or her behalf. In the event we select this option, we must provide written notice to the stockholders prior to the expiration of 60 days after the close of the relevant tax year.

For purposes of determining (i) whether the 90% Distribution Requirement is satisfied for any year and (ii) the amount of capital gains dividends paid for that year, we may, under certain circumstances, elect to treat a dividend that is paid during the following taxable year as if it had been paid during the taxable year in question. If we make such an election, the U.S. Stockholder will still be treated as receiving the dividend in the taxable year in which the distribution is made, and any capital gain dividend will be treated as a capital gain dividend to the U.S. Stockholder.

In addition, any dividend declared by us in October, November, or December of any calendar year, payable to stockholders of record on a specified date in such a month and actually paid during January of the following year will be treated as if it had been received by the stockholders on December 31 of the year in which the dividend was declared to the extent of earnings and profits for the calendar year.

In some taxable years, we may be subject to the alternative minimum tax (AMT). If we have tax items that are treated differently for AMT purposes than for regular tax purposes, we may apportion those items between us and our stockholders, and this may affect our stockholder s AMT liabilities. Although regulations explaining the precise method of apportionment have not yet been issued by the Internal Revenue Service, we may apportion these items in the same proportion that dividends paid to each stockholder bear to our taxable income (determined without regard to the dividends paid deduction), unless we determine that a different method for a particular item is warranted under the circumstances. You should consult your own tax advisor to determine how an investment in our stock could affect your AMT liability.

You should consider the tax implications of buying common stock just prior to a distribution. Even if the price of the common stock includes the amount of the forthcoming distribution, you may be taxed upon receipt of the distribution and will not be entitled to offset the distribution against the tax basis in your common stock.

You may recognize taxable gain or loss if you sell or exchange your common stock. The amount of the gain or loss will be measured by the difference between your adjusted tax basis in your common stock and the amount of the proceeds you receive in exchange for such stock. Any gain or loss arising from the sale or exchange of common stock generally will be a capital gain or loss. This capital gain or loss normally will be treated as a long-term capital gain or loss if you have held your common stock for more than one year; otherwise, it will be classified as short-term capital gain or loss. However, any capital loss arising from the sale or exchange of common stock held for six months or less generally will be treated as a long-term capital loss to the extent of the amount of capital gain dividends received (or treated as deemed distributed) with respect to such stock and, for this purpose, the special rules of Section 852(b)(4)(C) of the Code generally apply in determining the holding period of such stock. In addition, all or a portion of any loss realized upon a taxable disposition of common stock will be disallowed if other shares of our common stock are purchased (under our dividend reinvestment plan or otherwise) within 30 days before or after the disposition.

We will send to each of our stockholders, as promptly as possible after the end of each calendar year, a notice detailing, on a per share and per distribution basis, the amounts includible in such stockholder s taxable income for such year as ordinary income (including the amount of any qualified dividend income) and as long-term capital gains. In addition, the federal tax status of each year s distributions generally will be reported to the IRS. Distributions may also be subject to additional state, local, and foreign taxes depending on a stockholder s particular situation. Our ordinary income dividends to corporate stockholders may, if certain conditions are met, qualify for the dividends received deduction to the extent that we have received qualifying dividend income during the taxable year; capital gain dividends distributed by us are not eligible for the dividends received deduction.

A Non-U.S. Stockholder may be subject to withholding of U.S. federal tax at a 30% rate (or lower applicable treaty rate) on distributions (including certain redemptions of common stock) from us. However, the portion of our distributions that are properly designated by us as long-term capital gain dividends, short-term capital gain dividends or interest-related dividends may be exempt from such withholding if you have provided to us (or another appropriate withholding agent) in a timely manner a properly completed Form W-8BEN or applicable form. Currently, we do not anticipate that any significant amount of our distribution will be designated as eligible for this exemption from withholding. Non-U.S. Stockholders should consult their own tax advisors with respect to the appropriate forms to file to avoid withholding tax and for all other issues concerning U.S. federal income and withholding tax, and state, local, and foreign tax, consequences of an investment in our common stock.

We may be required to withhold U.S. federal income tax (backup withholding) at a 28% rate from all taxable distributions payable to (i) any stockholder who fails to furnish us with its correct taxpayer identification number or a certificate that the stockholder is exempt from backup withholding, and (ii) any stockholder with respect to whom the IRS notifies us that the stockholder has failed to properly report certain interest and dividend income to the IRS and to respond to notices to that effect. We may be required to report annually to the IRS and to each Non-U.S. Stockholder the amount of dividends paid to such stockholder and the amount, if any, of tax withheld pursuant to the backup withholding rules with respect to such dividends. This information may also be made available to the tax authorities in the Non-U.S. Stockholder s country of residence. Backup withholding is not an additional tax. Any amounts withheld under the backup withholding rules from payments made to a stockholder may be refunded or credited against such stockholder s United States federal income tax liability, if any, provided that the required information is furnished to the IRS.

You should consult your own tax advisor with respect to the particular tax consequences to you of an investment in us, including the possible effect of any pending legislation or proposed regulation.

CERTAIN GOVERNMENT REGULATIONS

We operate in a highly regulated environment. The following discussion generally summarizes certain government regulations that we are subject to.

Business Development Company. A business development company is defined and regulated by the 1940 Act. A business development company must be organized in the United States for the purpose of investing in or lending to primarily private companies and making managerial assistance available to them. A business development company may use capital provided by public shareholders and from other sources to invest in long-term, private investments in businesses. A business development company provides shareholders the ability to retain the liquidity of a publicly traded stock, while sharing in the possible benefits, if any, of investing in primarily privately owned companies.

As a business development company, we may not acquire any asset other than qualifying assets unless, at the time we make the acquisition, the value of our qualifying assets represent at least 70% of the value of our total assets. The principal categories of qualifying assets relevant to our business are:

- Securities purchased in transactions not involving any public offering, the issuer of which is an eligible portfolio company;
- Securities received in exchange for or distributed with respect to securities described in the bullet above or pursuant to the exercise of options, warrants or rights relating to such securities; and
- Cash, cash items, government securities or high quality debt securities (within the meaning of the 1940 Act), maturing in one year or less from the time of investment.

An eligible portfolio company is generally a domestic company that is not an investment company and that:

- does not have a class of securities with respect to which a broker may extend margin credit at the time the acquisition is made;
- is controlled by the business development company and has an affiliate of a business development company on its board of directors;
- does not have any class of securities listed on a national securities exchange; or
- meets such other criteria as may be established by the SEC.

Control, as defined by the 1940 Act, is presumed to exist where a business development company beneficially owns more than 25% of the outstanding voting securities of the portfolio company.

We do not intend to acquire securities issued by any investment company that exceed the limits imposed by the 1940 Act. Under these limits, we generally cannot acquire more than 3% of the voting stock of any investment company (as defined in the 1940 Act), invest more than 5% of the value of our total assets in the securities of one such investment company or invest more than 10% of the value of our total assets in the securities of such investment companies in the aggregate. With regard to that portion of our portfolio invested in securities issued by investment companies, it should be noted that such investments might subject our stockholders to additional expenses.

In October 2006, the SEC re-proposed rules providing for an additional definition of eligible portfolio company. As re-proposed, the rule would expand the definition of eligible portfolio company to include certain public companies that list their securities on a national securities exchange. The SEC sought comment regarding the application of this proposed rule to companies with: (1) a public float of less than $75 million; (2) a market capitalization of less than $150 million; or (3) a market capitalization of less than $250 million. There is no assurance that such proposal will be adopted or what the final proposal will entail.

To include certain securities described above as qualifying assets for the purpose of the 70% test, a business development company must make available to the issuer of those securities significant managerial assistance such as providing significant guidance and counsel concerning the management, operations, or business objectives and policies of a portfolio company. We offer to provide significant managerial assistance to our portfolio companies.

As a business development company, we are entitled to issue senior securities in the form of stock or senior securities representing indebtedness, including debt securities and preferred stock, as long as each class of senior security has an asset coverage of at least 200% immediately after each such issuance. In addition, while any senior securities remain outstanding, we must make provisions to prohibit any distribution to our shareholders unless we meet the applicable asset coverage ratio at the time of the distribution.

We are not generally able to issue and sell our common stock at a price below net asset value per share. We may, however, sell our common stock, at a price below the current net asset value of the common stock, or sell warrants, options or rights to acquire such common stock, at a price below the current net asset value of the common stock if our board of directors determines that such sale is in the best interests of the Company and our stockholders, and our stockholders approve our policy and practice of making such sales. We have included such a proposal in our proxy statement for our 2008 Annual Meeting of Stockholders. In any such case, the price at which our securities are to be issued and sold may not be less than a price which, in the determination of our board of directors, closely approximates the market value of such securities (less any distributing commission or discount).

We are also limited in the amount of stock options that may be issued and outstanding at any point in time. The 1940 Act provides that the amount of a business development company s voting securities that would result from the exercise of all outstanding warrants, options and rights at the time of issuance may not exceed 25% of the business development company s outstanding voting securities, except that if the amount of voting securities that would result from the exercise of all outstanding warrants, options, and rights issued to the business development company s directors, officers, and employees pursuant to any executive compensation plan would exceed 15% of the business development company s outstanding voting securities, then the amount of voting securities that would result from the exercise of all outstanding warrants, options, and rights at the time of issuance shall not exceed 20% of the outstanding voting securities of the business development company.

We have applied for an exemptive order of the SEC to permit us to issue restricted shares of our common stock as part of the compensation packages for certain of our employees and directors. There can be no assurance that the SEC will grant an exemptive order to allow the granting of restricted stock. In addition, the issuance of restricted shares of our common stock will require the approval of our stockholders.

We may also be prohibited under the 1940 Act from knowingly participating in certain transactions with our affiliates without the prior approval of the members of our Board of Directors who are not interested persons and, in some cases, prior approval by the SEC. We have been granted an exemptive order by the SEC permitting us to engage in certain transactions that would be permitted if we and our subsidiaries were one company and permitting certain transactions among our subsidiaries, subject to certain conditions and limitations.

We have designated a chief compliance officer and established a compliance program pursuant to the requirements of the 1940 Act. We are periodically examined by the SEC for compliance with the 1940 Act.

As with other companies regulated by the 1940 Act, a business development company must adhere to certain substantive regulatory requirements. A majority of our directors must be persons who are not interested persons, as that term is defined in the 1940 Act. Additionally, we are required to provide and maintain a bond issued by a reputable fidelity insurance company to protect us against larceny and embezzlement. Furthermore, as a business development company, we are prohibited from protecting any director or officer against any liability to us or our shareholders arising from willful misfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of such person s office.

We maintain a code of ethics that establishes procedures for personal investment and restricts certain transactions by our personnel. Our code of ethics generally does not permit investment by our employees in securities that have been or are contemplated to be purchased or held by us. Our code of ethics is posted on our website at www.alliedcapital.com and is also filed as an exhibit to our registration statement which is on file with the SEC. You may read and copy the code of ethics at the SEC s Public Reference Room in Washington, D.C. You may obtain information on operations of the Public Reference Room by calling the SEC at 1-800-SEC-0330. In addition, the code of ethics is available on the EDGAR database on the SEC Internet site at http://www.sec.gov. You may obtain copies of the code of ethics, after paying a duplicating fee, by electronic request at the following email address: publicinfo@sec.gov, or by writing to the SEC s Public Reference Section, 100 F Street, NE, Washington, D.C. 20549.

We may not change the nature of our business so as to cease to be, or withdraw our election as, a business development company unless authorized by vote of a majority of the outstanding voting securities, as defined in the 1940 Act. A majority of the outstanding voting securities of a company is defined under the 1940 Act as the lesser of: (i) 67% or more of such company s shares present at a meeting if more than 50% of the outstanding shares of such company are present and represented by proxy or (ii) more than 50% of the outstanding shares of such company.

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

Taxable income generally differs from net income for financial reporting purposes due to temporary and permanent differences in the recognition of income and expenses, and generally excludes net unrealized appreciation or depreciation, as gains or losses generally are not included in taxable income until they are realized. In addition, gains realized for financial reporting purposes may differ from gains included in taxable income as a result of our election to recognize gains using installment sale treatment, which generally results in the deferment of gains for tax purposes until notes or other amounts, including amounts held in escrow, received as consideration from the sale of investments are collected in cash.

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

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

Compliance with the Sarbanes-Oxley Act of 2002. The Sarbanes-Oxley Act of 2002 (the Sarbanes-Oxley Act) imposes a wide variety of regulatory requirements on publicly held companies and their insiders. Many of these requirements apply to us, including:

Our Chief Executive Officer and Chief Financial Officer certify the financial statements contained in our periodic reports through the filing of Section 302 certifications;

Our periodic reports disclose our conclusions about the effectiveness of our disclosure controls and procedures;

Our annual report on Form 10-K contains a report from our management on internal control over financial reporting, including a statement that our management is responsible for establishing and maintaining adequate internal control over financial reporting as well as our management s assessment of the effectiveness of our internal control over financial reporting, and an attestation report on the effectiveness of our internal control over financial reporting issued by our independent registered public accounting firm;

Our periodic reports disclose whether there were significant changes in our internal control over financial reporting or in other factors that could significantly affect our internal control over financial reporting subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses; and

We may not make any loan to any director or executive officer and we may not materially modify any existing loans.

We have adopted procedures to comply with the Sarbanes-Oxley Act and the regulations promulgated thereunder. We will continue to monitor our compliance with all future regulations that are adopted under the Sarbanes-Oxley Act and will take actions necessary to ensure that we are in compliance therewith.

We have adopted certain policies and procedures to comply with the New York Stock Exchange (NYSE) corporate governance rules. In accordance with the NYSE procedures, shortly after our 2008 Annual Meeting of Stockholders, we will submit the required CEO certification to the NYSE pursuant to Section 303A.12(a) of the listed company manual.

Proxy Voting Policies and Procedures

We vote proxies relating to our portfolio securities in the best interest of our shareholders. We review on a case-by-case basis each proposal submitted to a shareholder vote to determine its impact on the portfolio securities held by us. Although we generally vote against proposals that may have a negative impact on our portfolio securities, we may vote for such a proposal if there exists compelling long-term reasons to do so.

Our proxy voting decisions are made by our portfolio management committee. To ensure that our vote is not the product of a conflict of interest, we require that: (i) anyone involved in the decision making process disclose to our Chief Compliance Officer any potential conflict that he or she is aware of and any contact that he or she has had with any interested party regarding a proxy vote; and (ii) employees involved in the decision making process or vote administration are prohibited from revealing how we intend to vote on a proposal in order to reduce any attempted influence from interested parties.

Stockholders may obtain information regarding how we voted proxies with respect to our portfolio securities without charge by making a written request for proxy voting information to: Corporate Secretary, Allied Capital Corporation, 1919 Pennsylvania Avenue, N.W., Washington, D.C. 20006 or by telephone at (202) 721-6100.

STOCK TRADING PLANS

Our Board of Directors has established a policy to permit our officers and directors to enter into trading plans to sell shares of our common stock in accordance with Rule 10b5-1 of the Securities Act of 1934. The policy allows our participating officers and directors to adopt a pre-arranged stock trading plan to buy or sell pre-determined amounts of our shares of common stock over a period of time. Our Board of Directors established the policy in recognition of the liquidity and diversification objectives of our officers and directors, including the desire of certain of our officers and directors to sell certain shares of our common stock, subject to the target ownership program. See Target Ownership.

DIVIDEND REINVESTMENT PLAN

We currently maintain a dividend reinvestment plan that provides for reinvestment of our distributions on behalf of our shareholders by our transfer agent. The dividend reinvestment plan is an opt in plan, which means that if our Board of Directors declares a cash dividend then our shareholders that have not opted in to our dividend reinvestment plan will receive cash dividends, rather than reinvesting dividends in additional shares of common stock.

To enroll in the dividend reinvestment plan, each shareholder must complete an enrollment status form and return it to the plan agent. The plan agent shall then automatically reinvest any dividend in additional shares of common stock. Shareholders may change their status in the dividend reinvestment plan at any time by contacting our transfer agent and plan administrator in writing.

A shareholder s ability to participate in a dividend reinvestment plan may be limited according to how the shares of common stock are held. A nominee may preclude beneficial owners holding shares in street name from participating in the dividend reinvestment plan. Shareholders who wish to participate in a dividend reinvestment plan may need to hold their shares of common stock in their own name. Shareholders who hold shares in the name of a nominee should contact the nominee for details.

All distributions to investors who do not participate (or whose nominee elects not to participate) in the dividend reinvestment plan will be paid directly, or through the nominee, to the record holder by or under the discretion of the plan agent. The plan agent is American Stock Transfer and Trust Company, 59 Maiden Lane, New York, New York 10038. Their telephone number is (800) 937-5449.

Under the dividend reinvestment plan, we may issue new shares if the issue price of the new shares of common stock is greater than 110% of the last reported net asset value. Alternatively, the plan agent may buy shares of common stock in the market. We value newly issued shares of common stock for the dividend reinvestment plan at the average of the reported last sale prices of the outstanding shares of common stock on the last five trading days prior to the payment date of the distribution, but not less than 95% of the opening bid price on such date. The price in the case of shares bought in the market will be the average actual cost of such shares of common stock, including any brokerage commissions. There are no other fees charged to shareholders in connection with the dividend reinvestment plan. Any distributions reinvested under the plan will nevertheless remain taxable to the shareholders.

DESCRIPTION OF CAPITAL STOCK

The following summary description is based on relevant portions of the Maryland General Corporation Law and our charter and bylaws. This summary is not necessarily complete, and we refer you to the Maryland General Corporation Law and our charter and bylaws for a detailed description of the provisions summarized below.

Capital Stock

Our authorized capital stock consists of 400,000,000 shares, $0.0001 par value per share, all of which has been initially designated as common stock. Our Board of Directors may classify and reclassify any unissued shares of our capital stock by setting or changing in one or more respects the preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends, qualifications, terms or conditions or redemption or other rights of such shares of capital stock.

Common Stock

At May 6, 2008, there were 169,691,875 shares of common stock outstanding and 29,222,587 shares of common stock reserved for issuance under our amended stock option plan. The following are the outstanding classes of securities of Allied Capital as of May 6, 2008:

	(1) Title of Class	(2) Amount Authorized	(3) Amount Held by Us or for Our Account	(4) Amount Outstanding Exclusive of Amounts Shown Under(3)
Allied Capital Corporation	Common Stock	400,000,000		169,691,875

All shares of common stock have equal rights as to earnings, assets, dividends and voting and all outstanding shares of common stock are fully paid and non-assessable. Distributions may be paid to the holders of common stock if and when declared by our Board of Directors out of funds legally available therefor. Our common stock has no preemptive, exchange, conversion, or redemption rights and is freely transferable, except where their transfer is restricted by federal and state securities law or by contract. In the event of liquidation, dissolution or winding-up of Allied Capital, each share of common stock is entitled to share ratably in all of our assets that are legally available for distributions after payment of all debts and liabilities and subject to any prior rights of holders of preferred stock, if any, then outstanding. Each share of common stock is entitled to one vote on all matters submitted to a vote of shareholders, including the election of directors. Except as provided with respect to any other class or series of capital stock, the holders of our common stock will possess exclusive voting power. There is no cumulative voting in the election of directors, which means that holders of a majority of the shares, if they so choose, could elect all of the directors, and holders of less than a majority of the shares would, in that case, be unable to elect any director. All shares of common stock offered hereby will be, when issued and paid for, fully paid and non-assessable.

Preferred Stock

Our charter authorizes our Board of Directors to classify and reclassify any unissued shares of stock into other classes or series of stock, including preferred stock. Prior to issuance of shares of each class or series, the Board of Directors is required by Maryland law and by our charter to set the terms, preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends or other distributions, qualifications and terms or conditions of redemption for each class or series. Thus, the Board of Directors could authorize the issuance of shares of preferred stock with terms and conditions which could have the effect of delaying, deferring or preventing a transaction or a change in control that might involve a premium price for holders of our common stock or otherwise be in their best interest.

In addition, any issuance of preferred stock must comply with the requirements of the 1940 Act. The 1940 Act requires, among other things, that (1) immediately after issuance and before any dividend or other distribution is made with respect to our common stock, we maintain a coverage ratio of total assets to total senior securities, which include all of our borrowings and our preferred stock we may issue in the future, of at least 200%, and (2) the holders of shares of preferred stock, if any are issued, must be entitled as a class to elect two directors at all times and to elect a majority of the directors if dividends on such preferred stock are in arrears by two years or more. The features of preferred stock will be further limited by the requirements applicable to regulated investment companies under the Code.

Limitation on Liability of Directors and Officers; Indemnification and Advance of Expenses

We have adopted provisions in our charter limiting the liability of our directors and officers for monetary damages. The effect of these provisions in the charter is to eliminate the rights of Allied Capital and its stockholders (through stockholders derivative suits on our behalf) to recover monetary damages against a director or officer for breach of the fiduciary duty of care as a director or officer (including breaches resulting from negligent behavior) except for liability resulting from (i) actual receipt of an improper benefit or profit in money, property or services or (ii) active and deliberate dishonesty established by a final judgment as being material to the cause of action. These provisions do not limit or eliminate the rights of Allied Capital or any stockholder to seek non-monetary relief such as an injunction or rescission in the event of a breach of a director s or officer s duty of care. These provisions will not alter the liability of directors or officers under federal securities laws.

Our charter and bylaws authorize us, to the maximum extent permitted by Maryland law and subject to the requirements of the 1940 Act, to indemnify any present or former director or officer or any individual who, while a director and at our request, serves or has served another corporation, real estate investment trust, partnership, joint venture, trust, employee benefit plan or other enterprise as a director, officer, partner or trustee, from and against any claim or liability to which that person may become subject or which that person may incur by reason of his or her status as a present or former director or officer and to pay or reimburse their reasonable expenses in advance of final disposition of a proceeding. The charter and bylaws also permit us to indemnify and advance expenses to any person who served a predecessor of us in any of the capacities described above and any of our employees or agents or any employees or agents of our predecessor. In accordance with the 1940 Act, we will not indemnify any person for any liability to which such person would be subject by reason of such person s willful misfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of his or her office. In addition, we will only indemnify any person in a manner consistent with the SEC s policy regarding any request to hold harmless or indemnify any individual as permitted under Section 17(h) and 17(i) of the 1940 Act where liability has not been adjudicated, where the matter has been settled, or in a situation involving an advance of attorney s fees or other expenses.

Maryland law requires a corporation (unless its charter provides otherwise, which our charter does not) to indemnify a director or officer who has been successful, on the merits or otherwise, in the defense of any proceeding to which he or she is made a party by reason of his or her service in that capacity. Maryland law permits a corporation to indemnify its present and former directors and officers, among others, against judgments, penalties, fines, settlements and reasonable expenses actually incurred by them in connection with any proceeding to which they may be made a party by reason of their service in those or other capacities unless it is established that (a) the act or omission of the director or officer was material to the matter giving rise to the proceeding and (1) was committed in bad faith or (2) was the result of active and deliberate dishonesty, (b) the director or officer actually received an improper personal benefit in money, property or services or (c) in the case of any criminal proceeding, the director or officer had reasonable cause to believe that the act or omission was unlawful. However, under Maryland law, a Maryland corporation may not indemnify for an adverse judgment in a suit by or in the right of the corporation or for a judgment of liability on the basis that a personal benefit was improperly received, unless in either case a court orders indemnification, and then only for expenses. In addition, Maryland law

permits a corporation to advance reasonable expenses to a director or officer upon the corporation s receipt of (a) a written affirmation by the director or officer of his or her good faith belief that he or she has met the standard of conduct necessary for indemnification by the corporation and (b) a written undertaking by him or her or on his or her behalf to repay the amount paid or reimbursed by the corporation if it is ultimately determined that the standard of conduct was not met.

We have entered into indemnification agreements with our directors and certain of our senior officers. The indemnification agreements provide these directors and senior officers the maximum indemnification permitted under Maryland law and the 1940 Act.

Certain Anti-Takeover Provisions

Our charter and bylaws and certain statutory and regulatory requirements contain certain provisions that could make more difficult the acquisition of Allied Capital by means of a tender offer, a proxy contest or otherwise. These provisions are expected to discourage certain types of coercive takeover practices and inadequate takeover bids and to encourage persons seeking to acquire control of us to negotiate first with the Board of Directors. We believe that the benefits of these provisions outweigh the potential disadvantages of discouraging such proposals because, among other things, negotiation of such proposals might result in an improvement of their terms; however, such provisions may have the effect of depriving shareholders of an opportunity to sell their shares at a premium over market prices by discouraging a third party from seeking to obtain control of Allied Capital. The description set forth below is intended only to be a summary of certain of our anti-takeover provisions and is qualified in its entirety by reference to our charter and the bylaws.

Classified Board of Directors

Our bylaws provide for our Board of Directors to be divided into three classes of directors serving staggered three-year terms, with each class to consist as nearly as possible of one-third of the directors then elected to the board. A classified board may render more difficult a change in control of Allied Capital or removal of incumbent management. We believe, however, that the longer time required to elect a majority of a classified Board of Directors helps to ensure continuity and stability of our management and policies.

Issuance of Preferred Stock

Our Board of Directors, without stockholder approval, has the authority to reclassify authorized but unissued common stock as preferred stock and to issue preferred stock. Such stock could be issued with voting, conversion or other rights designed to have an anti-takeover effect.

Number of Directors; Vacancies; Removal

Our charter provides that the number of directors will be set only by the Board of Directors in accordance with our bylaws. Our bylaws provide that a majority of our entire Board of Directors may at any time increase or decrease the number of directors. However, unless our bylaws are amended, the number of directors may never be less than three nor more than fifteen. Except as may be provided by the Board of Directors in setting the terms of any class or series of preferred stock, any and all vacancies on the Board of Directors may be filled only by the affirmative vote of a majority of the remaining directors in office, even if the remaining directors do not constitute a quorum, and any director elected to fill a vacancy will serve for the remainder of the full term of the directorship in which the vacancy occurred and until a successor is elected and qualified.

Our bylaws provides that a director may be removed by stockholders only with cause and then only by the affirmative vote of at least a majority of the votes entitled to be cast in the election of directors.

Action by Stockholders

Under the Maryland General Corporation Law, stockholder action can be taken only at an annual or special meeting of stockholders or by unanimous written consent in lieu of a meeting. These provisions, combined with the requirements of our bylaws regarding the calling of a stockholder-requested special meeting of stockholders discussed below, may have the effect of delaying consideration of a stockholder proposal until the next annual meeting.

Advance Notice Provisions for Stockholder Nominations and Stockholder Proposals

Our bylaws provide that with respect to an annual meeting of stockholders, nominations of persons for election to the Board of Directors and the proposal of business to be considered by stockholders may be made only (1) pursuant to our notice of the meeting, (2) by the Board of Directors or (3) by a stockholder who is entitled to vote at the meeting and who has complied with the advance notice procedures of the bylaws. With respect to special meetings of stockholders, only the business specified in our notice of the meeting may be brought before the meeting. Nominations of persons for election to the Board of Directors at a special meeting may be made only (1) pursuant to our notice of the meeting, (2) by the Board of Directors or (3) provided that the Board of Directors has determined that directors will be elected at the meeting, by a stockholder who is entitled to vote at the meeting and who has complied with the advance notice provisions of the bylaws.

The purpose of requiring stockholders to give us advance notice of nominations and other business is to afford our Board of Directors a meaningful opportunity to consider the qualifications of the proposed nominees and the advisability of any other proposed business and, to the extent deemed necessary or desirable by our Board of Directors, to inform stockholders and make recommendations about such qualifications or business, as well as to provide a more orderly procedure for conducting meetings of stockholders. Although our bylaws do not give our Board of Directors any power to disapprove stockholder nominations for the election of directors or proposals recommending certain action, they may have the effect of precluding a contest for the election of directors or the consideration of stockholder proposals if proper procedures are not followed and of discouraging or deterring a third party from conducting a solicitation of proxies to elect its own slate of directors or to approve its own proposal without regard to whether consideration of such nominees or proposals might be harmful or beneficial to us and our stockholders.

Calling of Special Meetings of Stockholders

Our bylaws provide that special meetings of stockholders may be called by our Board of Directors and certain of our officers. Additionally, our bylaws provide that, subject to the satisfaction of certain procedural and informational requirements by the stockholders requesting the meeting, a special meeting of stockholders will be called by our Corporate Secretary upon the written request of stockholders entitled to cast not less than a majority of all the votes entitled to be cast at such meeting.

Amendments; Supermajority Vote Requirements

Our bylaws impose supermajority vote requirements in connection with the amendment of provisions of our bylaws, including those provisions relating to the classified Board of Directors, the ability of stockholders to call special meetings and the advance notice provisions for stockholder meetings.

Maryland General Corporation Law

Maryland General Corporation Law provides for the Business Combination Statute and the Control Share Acquisition Statute, as defined below. The partial summary of the foregoing statutes contained in this prospectus is not intended to be complete and reference is made to the full text of such statutes for their entire terms.

Business Combination Statute. Certain provisions of the Maryland General Corporation Law establish special requirements with respect to business combinations between Maryland corporations and interested stockholders unless exemptions are applicable (the Business Combination Statute). Among other things, the Business Combination Statute prohibits for a period of five years a merger or other specified transactions between a company and an interested stockholder and requires a supermajority vote for such transactions after the end of such five-year period.

Interested stockholders are all persons owning beneficially, directly or indirectly, 10% or more of the outstanding voting stock of a Maryland corporation. Business combinations include certain mergers or similar transactions subject to a statutory vote and additional transactions involving transfer of assets or securities in specified amounts to interested stockholders or their affiliates.

Unless an exemption is available, a business combination may not be consummated between a Maryland corporation and an interested stockholder or its affiliates for a period of five years after the date on which the stockholder first became an interested stockholder and thereafter may not be consummated unless recommended by the board of directors of the Maryland corporation and approved by the affirmative vote of at least 80% of the votes entitled to be cast by all holders of outstanding shares of voting stock and $66^2/3$% of the votes entitled to be cast by all holders of outstanding shares of voting stock other than the interested stockholder or its affiliates or associates, unless, among other things, the corporation s stockholders receive a minimum price (as defined in the Business Combination Statute) for their shares and the consideration is received in cash or in the same form as previously paid by the interested stockholder for its shares.

A business combination with an interested stockholder which is approved by the board of directors of a Maryland corporation at any time before an interested stockholder first becomes an interested stockholder is not subject to the five-year moratorium or special voting requirements. An amendment to a Maryland corporation s charter electing not to be subject to the foregoing requirements must be approved by the affirmative vote of at least 80% of the votes entitled to be cast by all holders of outstanding shares of voting stock and $66^2/3$% of the votes entitled to be cast by holders of outstanding shares of voting stock who are not interested stockholders. Any such amendment is not effective until 18 months after the vote of stockholders and does not apply to any business combination of a corporation with a stockholder who became an interested stockholder on or prior to the date of such vote.

Control Share Acquisition Statute. The Maryland General Corporation Law imposes limitations on the voting rights of shares acquired in a control share acquisition. The control share statute defines a control share acquisition to mean the acquisition, directly or indirectly, of control shares subject to certain exceptions. Control shares of a Maryland corporation are defined to be voting shares of stock which, if aggregated with all other shares of stock previously acquired by the acquiror, would entitle the acquiror to exercise voting power in electing directors with one of the following ranges of voting power:

(1) one-tenth or more but less than one-third;

(2) one-third or more but less than a majority; or

(3) a majority of all voting power.

The requisite stockholder approval must be obtained each time an acquiror crosses one of the thresholds of voting power set forth above. Control shares do not include shares which the acquiring person is entitled to vote as a result of having previously obtained stockholder approval. Control shares of a Maryland corporation acquired in a control share acquisition have no voting rights except to the extent approved by a vote of two-thirds of the votes entitled to be cast by stockholders in the election of directors, excluding shares of stock as to which the acquiring person, officers of the corporation and directors of the corporation who are employees of the corporation are entitled to exercise or direct the exercise of the voting power of the shares in the election of the directors.

The control share statute also requires Maryland corporations to hold a special meeting at the request of an actual or proposed control share acquiror generally within 50 days after a request is made with the submission of an acquiring person statement, but only if the acquiring person:

(1) gives a written undertaking and, if required by the directors of the issuing corporation, posts a bond for the cost of the meeting; and

(2) submits definitive financing agreements for the acquisition of the control shares to the extent that financing is not provided by the acquiring person.

In addition, unless the issuing corporation s charter or bylaws provide otherwise, the control share statute provides that the issuing corporation, within certain time limitations, shall have the right to redeem control shares (except those for which voting rights have previously been approved) for fair value as determined pursuant to the control share statute in the event:

(1) there is a stockholder vote and the grant of voting rights is not approved; or

(2) an acquiring person statement is not delivered to the target within 10 days following a control share acquisition.

Moreover, unless the issuing corporation s charter or bylaws provide otherwise, the control share statute provides that if, before a control share acquisition occurs, voting rights are accorded to control shares which result in the acquiring person having majority voting power, then all stockholders other than the acquiring person have appraisal rights as provided under the Maryland General Corporation Law. An acquisition of shares may be exempted from the control share statute provided that a charter or bylaw provision is adopted for such purpose prior to the control share acquisition by any person with respect to Allied Capital. The control share acquisition statute does not apply to shares acquired in a merger, consolidation or share exchange to which the corporation is a party.

Our Board of Directors has opted out of the Control Share Acquisition Statute through an amendment to our bylaws.

DESCRIPTION OF PUBLIC NOTES

The following summary description is based on the indenture between us and the Bank of New York, as trustee, dated June 16, 2006 (the Indenture) and any supplements to the Indenture. This summary is not necessarily complete and we refer you to the Indenture and any supplements to the Indenture for a detailed description of the provisions summarized below.

As of March 31, 2008, we have completed public issuances of unsecured notes as follows:

($ in millions)	Amount	Maturity Date
6.625% Notes due 2011[(1)(2)]	$ 400.0	July 15, 2011
6.000% Notes due 2012[(1)(2)]	250.0	April 1, 2012
6.875% Notes due 2047[(1)(3)]	230.0	April 15, 2047
Total	$ 880.0	

[(1)] The terms of the notes are governed by two additional covenants, through which we have agreed to not violate Section 18(a)(1)(A) as modified by Section 61(a)(1) of the 1940 Act, as amended, while the notes are outstanding, and to provide financial information to the holders of the notes and the trustee if we should no longer be subject to the reporting requirements under the Securities Exchange Act of 1934, as amended. The supplements to the Indenture governing the issuance of the notes also revise certain events of default. The amendments to the Indenture apply to the notes only and do not apply to any prior or future issuance of debt securities under the Indenture unless so provided in an applicable supplement to the Indenture.

(2) We may redeem the notes in whole at any time or in part from time to time provided that any exercise of our option to redeem the notes will be done in compliance with the 1940 Act, and the rules and regulations promulgated thereunder, to the extent applicable.

(3) These notes are listed on the New York Stock Exchange under the trading symbol AFC. We may redeem the notes in whole or in part at any time or from time to time on or after April 15, 2012, and upon the occurrence of certain tax events provided that any exercise of our option to redeem the notes will be done in compliance with the 1940 Act, and the rules and regulations promulgated thereunder, to the extent applicable.

The debt securities are our direct unsecured obligations and rank equally with our other outstanding unsecured indebtedness. The Indenture permits us to issue debt securities from time to time and debt securities issued under the Indenture will be issued as part of a series that has been established by us under such Indenture. We will initially issue all debt securities in global form, which form shall include master notes evidencing medium-term notes, commercial paper or retail notes.

DTC acts as securities depository for our debt securities. The debt securities were issued as fully-registered securities registered in the name of Cede & Co. (DTC s partnership nominee). One fully-registered certificate was issued for the debt securities in connection with each public offering, in the aggregate principal amount of such issue and was deposited with DTC. In the case of our 6.875% Notes due 2047, an additional fully-registered certificate was issued in the aggregate principal amount of the notes issued upon exercise by the underwriters of their option to purchase additional notes to cover over-allotments.

The following provisions apply to all series of debt securities issued under the Indenture including our outstanding public notes, except as set forth in the applicable supplemental indenture.

Mergers and Similar Transactions. We are generally permitted to consolidate or merge with another company. We are also permitted to sell substantially all of our assets to another company or to buy substantially all of the assets of another company. However, we may not consolidate or merge with another company or convey, transfer or lease our properties or assets substantially as an entirety or permit another company to consolidate or merge with us unless certain conditions are met.

Modification and Waiver of Contractual Rights. Under certain circumstances, we can make changes to the Indenture and the securities. Some types of changes require the approval of each security holder affected thereby, some require approval by a majority vote with respect to each affected series of securities and some changes do not require any approval at all.

Defeasance and Covenant Defeasance. When we establish a series of debt securities, we may provide that the series be subject to the defeasance and discharge provisions of the Indenture. If those provisions are made applicable, we may elect either:

- to defease and be discharged from, subject to some limitations, all of our obligations with respect to those debt securities; or

- to be released from our obligations to comply with certain covenants relating to those debt securities.

To effect the defeasance or covenant defeasance, we must irrevocably deposit in trust with the relevant trustee an amount in any combination of funds or government obligations, which, through the payment of principal and interest in accordance with their terms, will provide money sufficient to make payments on those debt securities and any mandatory sinking fund or analogous payments on those debt securities.

Redemption. The Indenture under which the debt securities are issued may permit us to redeem such securities. If so, we may be able to pay off such securities before their scheduled maturity. If we have this right with respect to specific securities, the right will be outlined in the applicable supplemental indenture. It will also specify when we can exercise this right and how much we will have to pay in order to redeem the debt securities.

Events of Default

A holder has special rights if an event of default occurs and is not cured. The following constitute events of default under the Indenture, unless otherwise specified in the applicable supplemental indenture.

we fail to make any interest payment on a security when it is due, and we do not cure this default within 30 days;

we fail to make any payment of principal when it is due at the maturity of any security, and we do not cure this default within 5 days;

we fail to deposit a sinking fund payment when due, and we do not cure this default within 5 days;

we fail to comply with the indenture, and after we have been notified of the default by the trustee or holders of 25% in principal amount of the series, we do not cure the default within 60 days;

we file for bankruptcy, or other events in bankruptcy, insolvency or reorganization occur and remain undischarged or unstayed for a period of 60 days;

on the last business day of each of twenty-four consecutive calendar months, we have an asset coverage of less than 100 per centum, or

any other event of default described as being applicable to any particular series of debt securities.

A holder has certain remedies if an event of default occurs as set forth in detail in the Indenture and in the applicable supplemental indenture.

The holders of a majority in principal amount of the relevant series of debt securities may waive a default for all the relevant series of debt securities. If this happens, the default will be treated as if it has not occurred. No one can waive a payment default on a holder s debt security, however, without his individual approval.

Certain Covenants

The Indenture under which the debt securities are issued will require us to, unless otherwise specified in the applicable supplemental indenture:

duly and punctually pay the principal of and any premium and interest on the debt securities of each series in accordance with the terms of the debt securities and the indenture;

maintain an office or agency where the debt securities may be presented or surrendered for payment, registration of transfer or exchange, and where notices and demands to or upon us regarding the securities and the indenture may be served. We will give prompt written notice to the trustee of the location, and any change in the location, of such office or agency;

if we act as our own paying agent at any time, segregate and hold in trust, for the benefit of the holders, an amount of money, in the currency in which the securities are payable, sufficient to pay the principal and any premium or interest due on the securities of any series on or before the due date for such payment;

do all things necessary to preserve and keep in full force and effect our existence, rights (charter and statutory) and franchises unless failure to do so would not disadvantage the Holders in any material respect;

deliver an officers certificate to the trustee, within 120 calendar days after the end of each fiscal year, stating whether or not, to the best knowledge of the persons signing the officers certificate, we are in default in the performance and observance of any of the terms, provisions and conditions of the indenture and, if we are, specifying all such defaults and the nature and status thereof of which we may have knowledge;

maintain, preserve, and keep our material properties that are used in the conduct of our business in good repair, condition and working order, ordinary wear and tear excepted; and

pay or discharge when due all taxes, assessments and governmental charges levied or imposed upon us or our income, profits or property, as well as all lawful claims for labor, materials and supplies that, if unpaid, might by law become a lien upon our property, except those contested in good faith or that would not have a material adverse effect on us.

PLAN OF DISTRIBUTION

We may offer, from time to time, up to 50,000,000 shares of our common stock. We may sell the shares of our common stock through underwriters or dealers, directly to one or more purchasers, through agents or through a combination of any such methods of sale. Any underwriter or agent involved in the offer and sale of the shares of our common stock will be named in the applicable prospectus supplement.

The distribution of the shares of our common stock may be effected from time to time in one or more transactions at a fixed price or prices, which may be changed, at prevailing market prices at the time of sale, at prices related to such prevailing market prices, or at negotiated prices. The offering price of the shares and the proceeds to us and any discounts, commissions or concessions allowed or reallowed or paid to any underwriters or dealers will be set forth in the applicable prospectus supplement.

In connection with the sale of the shares of our common stock, underwriters or agents may receive compensation from us or from purchasers of the shares of our common stock, for whom they may act as agents, in the form of discounts, concessions or commissions. Underwriters may sell shares of our common stock to or through dealers and such dealers may receive compensation in the form of discounts, concessions or commissions from the underwriters and/or commissions from the purchasers for whom they may act as agents. Underwriters, dealers and agents that participate in the distribution of shares of our common stock may be deemed to be underwriters under the Securities Act, and any discounts and commissions they receive from us and any profit realized by them on the resale of shares of our common stock may be deemed to be underwriting discounts and commissions under the Securities Act. Any such underwriter or agent will be identified and any such compensation received from us will be described in the applicable prospectus supplement.

Any common stock sold pursuant to a prospectus supplement will be quoted on the New York Stock Exchange, or another exchange on which the common stock is traded.

Under agreements into which we may enter, underwriters, dealers and agents who participate in the distribution of shares of our common stock may be entitled to indemnification by us against certain liabilities, including liabilities under the Securities Act. Underwriters, dealers and agents may engage in transactions with, or perform services for, us in the ordinary course of business.

If so indicated in the applicable prospectus supplement, we will authorize underwriters or other persons acting as our agents to solicit offers by certain institutions to purchase shares of our common stock from us pursuant to contracts providing for payment and delivery on a future date. Institutions with which such contracts may be made include commercial and savings banks, insurance companies, pension funds, investment companies, educational and charitable institutions and others, but in all cases such institutions must be approved by us. The obligations of any purchaser under any such contract will be subject to the condition that the purchase of shares of our common stock shall not at the time of delivery be prohibited under the laws of the jurisdiction to which such purchaser is subject. The underwriters and such other agents will not have any responsibility in respect of the validity or performance of such contracts. Such contracts will be subject only to those conditions set forth in the prospectus supplement, and the prospectus supplement will set forth the commission payable for solicitation of such contracts.

The maximum commission or discount to be received by any member of the Financial Industry Regulatory Authority or independent broker-dealer will not be greater than 10% for the sale of any securities being registered and 0.5% for due diligence.

In order to comply with the securities laws of certain states, if applicable, shares of our common stock offered hereby will be sold in such jurisdictions only through registered or licensed brokers or dealers.

LEGAL MATTERS

The legality of shares of our common stock offered hereby will be passed upon for us by Sutherland Asbill & Brennan LLP, Washington, D.C. Certain legal matters will be passed upon for underwriters, if any, by the counsel named in the prospectus supplement.

CUSTODIANS, TRANSFER AND DIVIDEND PAYING AGENT AND REGISTRAR

Certain of our securities are held in safekeeping by PNC Bank, N.A., 808 17th Street, N.W., Washington, D.C. 20006. Other securities are held in custody at Chevy Chase Bank, 7501 Wisconsin Avenue, 14th Floor, Bethesda, Maryland 20814, Bank of America, 8300 Greensboro Drive, Suite 620, McLean, Virginia 22102, Union Bank of California, 350 California Street, 6th Floor, San Francisco, CA 94104, M&T Investment Group, 25 South Charles Street MD2-CS57, Baltimore, MD 21201 and Branch Banking and Trust Company, 223 West Nash Street, Corporate Trust, 2nd Floor, Wilson, NC 27893. American Stock Transfer and Trust Company, 59 Maiden Lane, New York, New York 10038 acts as our transfer, dividend paying and reinvestment plan agent and registrar for our common stock. The Bank of New York, 101 Barclay St., New York, New York acts as our registrar, paying agent and transfer agent for our publicly issued debt securities.

BROKERAGE ALLOCATION AND OTHER PRACTICES

Since we generally acquire and dispose of our investments in privately negotiated transactions, we rarely use brokers in the normal course of business. In those cases where we do use a broker, we do not execute transactions through any particular broker or dealer, but will seek to obtain the best net results for Allied Capital, taking into account such factors as price (including the applicable brokerage commission or dealer spread), size of order, difficulty of execution, and operational facilities of the firm and the firm s risk and skill in positioning blocks of securities. While we generally seek reasonably competitive execution costs, we may not necessarily pay the lowest spread or commission available. Subject to applicable legal requirements, we may select a broker based partly upon brokerage or research services provided to us. In return for such services, we may pay a higher commission than other brokers would charge if we determine in good faith that such commission is reasonable in relation to the services provided.

INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The consolidated financial statements as of December 31, 2007 and 2006, and for each of the years in the three-year period ended December 31, 2007, the related financial statement schedule as of December 31, 2007, and the senior securities table as of December 31, 2007, have been included herein in reliance upon the reports of KPMG LLP (KPMG), independent registered public accounting firm, located at 2001 M Street, NW, Washington, DC 20036, appearing elsewhere herein, and upon the authority of said firm as experts in accounting and auditing. KPMG s report on the consolidated financial statements refers to our adoption, effective January 1, 2006, of Statement of Accounting Standards No. 123 (Revised 2004), *Share Based Payment.*

With respect to the unaudited interim financial information as of March 31, 2008, and for the three-month periods ended March 31, 2008 and 2007, included herein, KPMG LLP has reported that they applied limited procedures in accordance with professional standards for a review of such information. However, their separate report included herein states that they did not audit and they do not express an opinion on that interim financial information. Accordingly, the degree of reliance on their report on such information should be restricted in light of the limited nature of the review procedures applied. The accountants are not subject to the liability provisions of Section 11 of the Securities Act of 1933 for their report on the unaudited interim financial information because that report is not a report or a part of the registration statement prepared or certified by the accountants within the meaning of Sections 7 and 11 of the Securities Act of 1933.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED FINANCIAL STATEMENTS
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Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders
Allied Capital Corporation:

We have audited the accompanying consolidated balance sheet of Allied Capital Corporation and subsidiaries (the Company) as of December 31, 2007 and 2006, including the consolidated statements of investments as of December 31, 2007 and 2006, and the related consolidated statements of operations, changes in net assets and cash flows, and the financial highlights (included in Note 13), for each of the years in the three-year period ended December 31, 2007. These consolidated financial statements and financial highlights are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements and financial highlights based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and financial highlights are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our procedures included physical inspection or confirmation of securities owned as of December 31, 2007 and 2006. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements and financial highlights referred to above present fairly, in all material respects, the financial position of Allied Capital Corporation and subsidiaries as of December 31, 2007 and 2006, and the results of their operations, their cash flows, changes in their net assets, and financial highlights for each of the years in the three-year period ended December 31, 2007, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 2 to the consolidated financial statements, effective January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123 (Revised 2004), *Share Based Payment.*

Washington, D.C.
February 28, 2008

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET

(in thousands, except per share amounts)	December 31, 2007	December 31, 2006
ASSETS		
Portfolio at value:		
Private finance		
Companies more than 25% owned (cost: 2007-$1,622,094; 2006-$1,578,822)	$ 1,279,080	$ 1,490,180
Companies 5% to 25% owned (cost: 2007-$426,908; 2006-$438,560)	389,509	449,813
Companies less than 5% owned (cost: 2007-$2,994,880; 2006-$2,479,981)	2,990,732	2,437,908
Total private finance (cost: 2007-$5,043,882; 2006-$4,497,363)	4,659,321	4,377,901
Commercial real estate finance (cost: 2007-$96,942; 2006-$103,546)	121,200	118,183
Total portfolio at value (cost: 2007-$5,140,824; 2006-$4,600,909)	4,780,521	4,496,084
Investments in money market and other securities	201,222	202,210
Accrued interest and dividends receivable	71,429	64,566
Other assets	157,864	122,958
Cash	3,540	1,687
Total assets	$ 5,214,576	$ 4,887,505
LIABILITIES AND SHAREHOLDERS EQUITY		
Liabilities:		
Notes payable and debentures (maturing within one year: 2007-$153,000; 2006-$)	$ 1,922,220	$ 1,691,394
Revolving line of credit	367,250	207,750
Accounts payable and other liabilities	153,259	147,117
Total liabilities	2,442,729	2,046,261
Commitments and contingencies		
Shareholders equity:		
Common stock, $0.0001 par value, 400,000 shares authorized; 158,002 and 148,575 shares issued and outstanding at December 31, 2007 and 2006, respectively	16	15
Additional paid-in capital	2,657,939	2,493,335
Common stock held in deferred compensation trust	(39,942)	(28,335)
Notes receivable from sale of common stock	(2,692)	(2,850)
Net unrealized appreciation (depreciation)	(379,327)	(123,084)
Undistributed earnings	535,853	502,163
Total shareholders equity	2,771,847	2,841,244

Total liabilities and shareholders equity	$	5,214,576	$	4,887,505
Net asset value per common share	$	17.54	$	19.12

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF OPERATIONS

	For the Years Ended December 31,		
(in thousands, except per share amounts)	**2007**	**2006**	**2005**
Interest and Related Portfolio Income:			
Interest and dividends			
Companies more than 25% owned	$ 105,634	$ 102,636	$ 122,450
Companies 5% to 25% owned	41,577	39,754	21,924
Companies less than 5% owned	270,365	244,037	172,779
Total interest and dividends	417,576	386,427	317,153
Fees and other income			
Companies more than 25% owned	18,505	29,606	27,365
Companies 5% to 25% owned	810	4,447	124
Companies less than 5% owned	24,814	32,078	29,510
Total fees and other income	44,129	66,131	56,999
Total interest and related portfolio income	461,705	452,558	374,152
Expenses:			
Interest	132,080	100,600	77,352
Employee	89,155	92,902	78,300
Employee stock options	35,233	15,599	
Administrative	50,580	39,005	69,713
Total operating expenses	307,048	248,106	225,365
Net investment income before income taxes	154,657	204,452	148,787
Income tax expense, including excise tax	13,624	15,221	11,561
Net investment income	141,033	189,231	137,226
Net Realized and Unrealized Gains (Losses):			
Net realized gains (losses)			
Companies more than 25% owned	226,437	513,314	33,237
Companies 5% to 25% owned	(10,046)	4,467	5,285
Companies less than 5% owned	52,122	15,520	234,974
Total net realized gains	268,513	533,301	273,496
Net change in unrealized appreciation or depreciation	(256,243)	(477,409)	462,092
Total net gains	12,270	55,892	735,588
Net increase in net assets resulting from operations	$ 153,303	$ 245,123	$ 872,814

Basic earnings per common share		$ 1.00	$ 1.72	$ 6.48
Diluted earnings per common share		$ 0.99	$ 1.68	$ 6.36
Weighted average common shares outstanding	basic	152,876	142,405	134,700
Weighted average common shares outstanding	diluted	154,687	145,599	137,274

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 Years Ended December 31, 2007	2006	2005
Operations:			
Net investment income	$ 141,033	$ 189,231	$ 137,226
Net realized gains	268,513	533,301	273,496
Net change in unrealized appreciation or depreciation	(256,243)	(477,409)	462,092
Net increase in net assets resulting from operations	153,303	245,123	872,814
Shareholder distributions:			
Common stock dividends	(407,317)	(354,892)	(314,509)
Preferred stock dividends	(10)	(10)	(10)
Net decrease in net assets resulting from shareholder distributions	(407,327)	(354,902)	(314,519)
Capital share transactions:			
Sale of common stock	171,282	295,769	
Issuance of common stock for portfolio investments			7,200
Issuance of common stock in lieu of cash distributions	17,095	14,996	9,257
Issuance of common stock upon the exercise of stock options	14,251	11,734	66,688
Cash portion of option cancellation payment	(52,833)		
Stock option expense	35,810	15,835	
Net decrease in notes receivable from sale of common stock	158	1,018	1,602
Purchase of common stock held in deferred compensation trust	(12,444)	(9,855)	(7,968)
Distribution of common stock held in deferred compensation trust	837	980	2,011
Other	10,471		3,683
Net increase in net assets resulting from capital share transactions	184,627	330,477	82,473
Total net increase (decrease) in net assets	(69,397)	220,698	640,768
Net assets at beginning of year	2,841,244	2,620,546	1,979,778
Net assets at end of year	$ 2,771,847	$ 2,841,244	$ 2,620,546
Net asset value per common share	$ 17.54	$ 19.12	$ 19.17
Common shares outstanding at end of year	158,002	148,575	136,697

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOWS

	For the Years Ended December 31,		
(in thousands)	**2007**	**2006**	**2005**
Cash flows from operating activities:			
Net increase in net assets resulting from operations	$ 153,303	$ 245,123	$ 872,814
Adjustments:			
Portfolio investments	(1,845,973)	(2,257,828)	(1,668,113)
Principal collections related to investment repayments or sales	1,211,550	1,055,347	1,503,388
Change in accrued or reinvested interest and dividends	(23,913)	(8,159)	(6,594)
Net collection (amortization) of discounts and fees	(4,101)	1,713	(1,564)
Redemption of (investments in) U.S. Treasury bills		100,000	(100,000)
Redemption of (investments in) money market securities	988	(80,243)	(121,967)
Stock option expense	35,810	15,835	
Changes in other assets and liabilities	(12,466)	36,418	33,023
Depreciation and amortization	2,064	1,800	1,820
Realized gains from the receipt of notes and other consideration from sale of investments, net of collections	(17,706)	(209,049)	(4,293)
Realized losses	131,997	24,169	69,565
Net change in unrealized (appreciation) or depreciation	256,243	477,409	(462,092)
Net cash provided by (used in) operating activities	(112,204)	(597,465)	115,987
Cash flows from financing activities:			
Sale of common stock	171,282	295,769	
Sale of common stock upon the exercise of stock options	14,251	11,734	66,688
Collections of notes receivable from sale of common stock	158	1,018	1,602
Borrowings under notes payable	230,000	700,000	350,000
Repayments on notes payable and debentures		(203,500)	(219,700)
Net borrowings under (repayments on) revolving line of credit	159,500	116,000	(20,250)
Cash portion of option cancellation payment	(52,833)		
Purchase of common stock held in deferred compensation trust	(12,444)	(9,855)	(7,968)
Other financing activities	1,798	(6,795)	(8,333)
Common stock dividends and distributions paid	(397,645)	(336,572)	(303,813)
Preferred stock dividends paid	(10)	(10)	(10)
Net cash provided by (used in) financing activities	114,057	567,789	(141,784)
Net increase (decrease) in cash	1,853	(29,676)	(25,797)
Cash at beginning of year	1,687	31,363	57,160
Cash at end of year	$ 3,540	$ 1,687	$ 31,363

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF INVESTMENTS

Private Finance Portfolio Company (in thousands, except number of shares)	Investment[(1)(2)]	December 31, 2007 Principal	Cost	Value
Companies More Than 25% Owned				
Alaris Consulting, LLC	Senior Loan (16.5%, Due 12/05 12/07)[(6)]	$ 27,055	$ 26,987	$
(Business Services)	Equity Interests		5,189	
	Guaranty ($1,100)			
AllBridge Financial, LLC	Equity Interests		7,800	7,800
(Financial Services)	Standby Letter of Credit ($30,000)			
Allied Capital Senior Debt Fund, L.P.[(5)]	Equity Interests (See Note 3)		31,800	32,811
(Private Debt Fund)				
Avborne, Inc.[(7)]	Preferred Stock (12,500 shares)		611	1,633
(Business Services)	Common Stock (27,500 shares)			
Avborne Heavy Maintenance, Inc.[(7)]	Preferred Stock (1,568 shares)		2,401	2,557
(Business Services)	Common Stock (2,750 shares)			370
	Guaranty ($2,401)			
Aviation Properties Corporation	Common Stock (100 shares)		65	
(Business Services)	Standby Letters of Credit ($1,000)			
Border Foods, Inc.	Preferred Stock (100,000 shares)		12,721	4,648
(Consumer Products)	Common Stock (148,838 shares)		3,847	
Calder Capital Partners, LLC[(5)]	Senior Loan (9.4%, Due 5/09)[(6)]	2,907	2,907	3,035
(Financial Services)	Equity Interests		2,396	3,559
Callidus Capital Corporation	Subordinated Debt (18.0%, Due 10/08)	6,871	6,871	6,871
(Financial Services)	Common Stock (100 shares)		2,067	44,587
Ciena Capital LLC (f/k/a Business Loan Express, LLC)	Class A Equity Interests(25.0% See Note 3)[(6)]	99,044	99,044	68,609
(Financial Services)	Class B Equity Interests		119,436	
	Class C Equity Interests		109,301	
	Guaranty ($258,707 See Note 3)			

	Standby Letters of Credit ($18,000 See Note 3)			
CitiPostal Inc. (Business Services)	Senior Loan (8.4%, Due 12/13)	692	679	679
	Unitranche Debt (12.0%, Due 12/13)	50,852	50,597	50,597
	Subordinated Debt (16.0%, Due 12/15)	8,049	8,049	8,049
	Common Stock (37,024 shares)		12,726	12,726
Coverall North America, Inc. (Business Services)	Unitranche Debt (12.0%, Due 7/11)	35,054	34,923	34,923
	Subordinated Debt (15.0%, Due 7/11)	6,000	5,979	5,979
	Common Stock (884,880 shares)		16,648	27,597
CR Holding, Inc.	Subordinated Debt (16.6%, Due 2/13)	40,956	40,812	40,812
(Consumer Products)	Common Stock (37,200,551 shares)		33,321	40,934
Direct Capital Corporation	Subordinated Debt (16.0%, Due 3/13)	39,184	39,030	39,030
(Financial Services)	Common Stock (2,097,234 shares)		19,250	6,906
Financial Pacific Company	Subordinated Debt (17.4%, Due 2/12 8/12)	73,031	72,850	72,850
(Financial Services)	Preferred Stock (10,964 shares)		10,276	19,330
	Common Stock (14,735 shares)		14,819	38,544
ForeSite Towers, LLC (Tower Leasing)	Equity Interest			878

(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.

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

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

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

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

Private Finance Portfolio Company (in thousands, except number of shares)	**Investment[1][2]**	**December 31, 2007 Principal**	**Cost**	**Value**
Global Communications, LLC (Business Services)	Senior Loan (10.0%, Due 9/02)[6]	$ 1,822	$ 1,822	$ 1,822
Hot Stuff Foods, LLC (Consumer Products)	Senior Loan (8.4%, Due 2/11-2/12)	50,940	50,752	50,752
	Subordinated Debt (12.1%, Due 8/12)	30,000	29,907	29,907
	Subordinated Debt (15.4%, Due 2/13)[6]	52,373	52,150	1,337
	Common Stock (1,147,453 shares)		56,187	
Huddle House, Inc. (Retail)	Subordinated Debt (15.0%, Due 12/12)	59,857	59,618	59,618
	Common Stock (415,328 shares)		41,533	44,154
Impact Innovations Group, LLC (Business Services)	Equity Interests in Affiliate			320
Insight Pharmaceuticals Corporation (Consumer Products)	Subordinated Debt (15.0%, Due 9/12)	44,257	44,136	45,041
	Subordinated Debt (19.0%, Due 9/12)[6]	16,181	16,130	16,796
	Preferred Stock (25,000 shares)		25,000	1,462
	Common Stock (620,000 shares)		6,325	
Jakel, Inc. (Industrial Products)	Subordinated Debt (15.5%, Due 3/08)[6]	1,563	1,563	1,563
Legacy Partners Group, Inc. (Financial Services)	Senior Loan (14.0%, Due 5/09)[6]	3,843	3,843	3,843
	Equity Interests		4,261	1,332
Litterer Beteiligungs-GmbH[4] (Business Services)	Subordinated Debt (8.0%, Due 12/08)	772	772	772
	Equity Interest		1,809	700
MVL Group, Inc. (Business Services)	Senior Loan (12.0%, Due 6/09 7/09)	30,674	30,639	30,639
	Subordinated Debt (14.5%, Due 6/09 7/09)	40,191	39,943	39,943
	Common Stock (648,661 shares)		643	4,949
Old Orchard Brands, LLC (Consumer Products)	Subordinated Debt (18.0%, Due 7/14)	19,632	19,544	19,544
	Equity Interests		18,767	25,419

Penn Detroit Diesel Allison, LLC	Subordinated Debt (15.5%, Due 8/13)	39,331	39,180	39,180
(Business Services)	Equity Interests		21,128	37,965
Powell Plant Farms, Inc.	Senior Loan (15.0%, Due 12/07)(6)	1,350	1,350	1,534
(Consumer Products)				

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(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.

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

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

Private Finance Portfolio Company (in thousands, except number of shares)	Investment[1][2]	December 31, 2007 Principal	Cost	Value
Service Champ, Inc.	Subordinated Debt (15.5%, Due 4/12)	$ 28,443	$ 28,351	$ 28,351
(Business Services)	Common Stock (63,888 shares)		13,662	26,292
Staffing Partners Holding Company, Inc.	Subordinated Debt (13.5%, Due 1/07)[6]	509	509	223
(Business Services)				
Startec Equity, LLC (Telecommunications)	Equity Interests		190	430
Sweet Traditions, Inc.	Senior Loan (13.0%, Due 9/08 8/11)[6]	39,692	36,052	35,229
(Retail)	Preferred Stock (961 shares)		950	
	Common Stock (10,000 shares)		50	
Triview Investments, Inc.[8]	Senior Loan (10.0%, Due 12/07)	433	433	433
(Broadcasting & Cable/Business Services/Consumer Products)	Subordinated Debt (12.9%, Due 1/10 6/17)	43,157	42,977	42,977
	Subordinated Debt (12.5%, Due 11/07 3/08)[6]	1,400	1,400	1,583
	Common Stock (202 shares)		120,638	83,453
	Guaranty ($900)			
	Standby Letter of Credit ($200)			
Unitranche Fund LLC	Subordinated Certificates		744	744
(Private Debt Fund)	Equity Interests		1	1
Worldwide Express Operations, LLC	Subordinated Debt (14.0%, Due 2/14)	2,845	2,670	2,670
(Business Services)	Equity Interests		12,900	21,516
	Warrants		163	272
Total companies more than 25% owned			$ 1,622,094	$ 1,279,080
Companies 5% to 25% Owned				
10th Street, LLC	Subordinated Debt (13.0%, Due 12/14)	$ 20,774	$ 20,645	$ 20,645

(Business Services)	Equity Interests		446	1,100
Advantage Sales & Marketing, Inc.	Subordinated Debt (12.0%, Due 3/14)	155,432	154,854	154,854
(Business Services)	Equity Interests			10,973
Air Medical Group Holdings LLC	Senior Loan (7.8%, Due 3/11)	3,030	2,980	2,980
(Healthcare Services)	Equity Interests		3,470	10,800
Alpine ESP Holdings, Inc.	Preferred Stock (622 shares)		622	749
(Business Services)	Common Stock (13,513 shares)		14	262
Amerex Group, LLC	Subordinated Debt (12.0%, Due 1/13)	8,400	8,400	8,400
(Consumer Products)	Equity Interests		3,509	13,713
BB&T Capital Partners/Windsor Mezzanine Fund, LLC (5) (Private Equity Fund)	Equity Interests		11,739	11,467
Becker Underwood, Inc.	Subordinated Debt (14.5%, Due 8/12)	24,865	24,798	24,798
(Industrial Products)	Common Stock(5,073 shares)		5,813	4,190
BI Incorporated	Subordinated Debt (13.5%, Due 2/14)	30,615	30,499	30,499
(Business Services)	Common Stock (40,000 shares)		4,000	7,382

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(8) Triview Investments, Inc. had a cost basis of $165.4 million and holds investments in Longview Cable & Data, LLC (Broadcasting & Cable) with a value of $7.0 million, Triax Holdings, LLC (Consumer Products) with a value of $62.0 million, and Crescent Hotels & Resorts, LLC and affiliates (Business Services) with a value of $59.4 million, for a total value of $128.4 million.

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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, 2007 Principal	Cost	Value
Creative Group, Inc.	Subordinated Debt (14.0%, Due 9/13)[6]	$ 15,000	$ 13,686	$ 6,197
(Business Services)	Common Stock (20,000 shares)			
	Warrant		1,387	
Drew Foam Companies, Inc.	Preferred Stock (722 shares)		722	396
(Business Services)	Common Stock (7,287 shares)		7	
MedBridge Healthcare, LLC	Senior Loan (8.0%, Due 8/09)[6]	7,164	7,164	7,164
(Healthcare Services)	Subordinated Debt (10.0%, Due 8/14)[6]	5,184	5,184	2,406
	Convertible Subordinated Debt (2.0%, Due 8/14)[6]	2,970	984	
	Equity Interests		1,416	
MHF Logistical Solutions, Inc.	Subordinated Debt (11.5%, Due 6/12)[6]	33,600	33,448	9,280
(Business Services)	Subordinated Debt (18.0%, Due 6/13)[6]	11,211	11,154	
	Common Stock (20,934 shares)[12]		20,942	
	Warrants[12]			
Multi-Ad Services, Inc.	Unitranche Debt (11.3%, Due 11/11)	19,800	19,704	19,704
(Business Services)	Equity Interests		2,000	940
Progressive International Corporation	Subordinated Debt (16.0%, Due 12/09)	1,557	1,545	1,545
(Consumer Products)	Preferred Stock (500 shares)		500	1,038
	Common Stock (197 shares)		13	4,900
	Warrants			
Regency Healthcare Group, LLC	Unitranche Debt (11.1%, Due 6/12)	12,000	11,941	11,941
(Healthcare Services)	Equity Interests		1,500	1,681
SGT India Private Limited[4]	Common Stock (150,596 shares)		4,098	3,075
(Business Services)				
Soteria Imaging Services, LLC		14,500	13,744	13,744

	Subordinated Debt (12.0%, Due 11/10)			
(Healthcare Services)	Equity Interests		2,170	2,686
Universal Environmental Services, LLC (Business Services)	Equity Interests		1,810	
Total companies 5% to 25% owned			$ 426,908	$ 389,509

Companies Less Than 5% Owned

3SI Security Systems, Inc. (Consumer Products)	Subordinated Debt (14.5%, Due 8/13)	$ 27,937	$ 27,837	$ 27,837
AgData, L.P. (Consumer Services)	Senior Loan (10.3%, Due 7/12)	843	815	815
Axium Healthcare Pharmacy, Inc.	Senior Loan (12.5%, Due 12/12)	2,600	2,567	2,567
(Healthcare Services)	Unitranche Debt (12.5%, Due 12/12)	8,500	8,463	8,463
	Common Stock (26,500 shares)		2,650	1,097
Baird Capital Partners IV Limited Partnership(5) (Private Equity Fund)	Limited Partnership Interest		2,234	2,114

(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.

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(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, 2007 Principal	Cost	Value
BenefitMall, Inc.	Subordinated Debt (14.9%, Due 10/13-10/14)	$ 82,167	$ 81,930	$ 81,930
(Business Services)	Common Stock (45,528,000 shares)[12]		45,528	82,404
	Warrants[12]			
	Standby Letters of Credit ($3,961)			
Broadcast Electronics, Inc. (Business Services)	Senior Loan (9.0%, Due 7/12)[6]	4,913	4,884	3,273
Bushnell, Inc. (Consumer Products)	Subordinated Debt (11.3%, Due 2/14)	41,325	39,821	39,821
Callidus Debt Partners CDO Fund I, Ltd.[4][10]	Class C Notes (12.9%, Due 12/13)	18,800	18,929	18,988
(CDO/CLO)	Class D Notes (17.0%, Due 12/13)	9,400	9,465	9,494
Callidus Debt Partners CLO Fund III, Ltd. [4][10] (CDO/CLO)	Preferred Shares (23,600,000 shares, 12.9%)[11]		21,783	19,999
Callidus Debt Partners CLO Fund IV, Ltd.[4][10] (CDO/CLO)	Income Notes (14.8%)[11]		12,298	11,290
Callidus Debt Partners CLO Fund V, Ltd. [4][10] (CDO/CLO)	Income Notes (20.3%)[11]		13,977	14,658
Callidus Debt Partners CLO Fund VI, Ltd.[4][10]	Class D Notes (11.3%) Due 10/21)	5,000	4,329	4,329
(CDO/CLO)	Income Notes (19.3%)[11]		26,985	26,985
Callidus Debt Partners [4][10] CLO Fund VII, Ltd. (CDO/CLO)	Income Notes (16.6%)[11]		22,113	22,113
Callidus MAPS CLO Fund I LLC[10]	Class E Notes (10.4%, Due 12/17)	17,000	17,000	16,119
(CDO/CLO)	Income Notes (5.6%)[11]		49,252	36,085

Callidus MAPS CLO Fund II, Ltd.(4)(10) (CDO/CLO)	Income Notes (14.7%)(11)		18,753	18,753
Camden Partners Strategic Fund II, L.P.(5) (Private Equity Fund)	Limited Partnership Interest		997	1,350
Carlisle Wide Plank Floors, Inc. (Consumer Products)	Senior Loan (9.8%, Due 6/11)	500	497	497
	Unitranche Debt (10.0%, Due 6/11)	3,161	3,129	3,129
	Preferred Stock (400,000 Shares)		400	507
Catterton Partners V, L.P.(5) (Private Equity Fund)	Limited Partnership Interest		3,624	2,952
Catterton Partners VI, L.P.(5) (Private Equity Fund)	Limited Partnership Interest		2,259	2,103
Centre Capital Investors IV, L.P.(5) (Private Equity Fund)	Limited Partnership Interest		2,215	2,276
Centre Capital Investors V, L.P.(5) (Private Equity Fund)	Limited Partnership Interest		628	628

(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.

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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 from companies less than 5% owned 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)]	December 31, 2007 Principal	Cost	Value
CK Franchising, Inc. (Consumer Services)	Senior Loan (8.7%, Due 7/12)	$ 9,000	$ 8,911	$ 8,911
	Subordinated Debt (12.3%, Due 7/12 7/17)	21,000	20,908	20,908
	Preferred Stock (1,486,004 shares)		1,486	1,586
	Common Stock (8,793,408 shares)		8,793	8,654
Commercial Credit Group, Inc. (Financial Services)	Subordinated Debt (14.8%, Due 2/11)	12,000	12,023	12,023
	Preferred Stock (74,978 shares)		18,018	19,421
	Warrants			
Community Education Centers, Inc. (Education Services)	Subordinated Debt (13.5%, Due 11/13)	35,011	34,936	34,936
Component Hardware Group, Inc. (Industrial Products)	Subordinated Debt (13.5%, Due 1/13)	18,432	18,363	18,363
Cook Inlet Alternative Risk, LLC (Business Services)	Unitranche Debt (10.8%, Due 4/13)	95,000	94,530	94,530
	Equity Interests		640	1,696
Cortec Group Fund IV, L.P.[(5)] (Private Equity)	Limited Partnership Interest		3,383	2,922
Diversified Mercury Communications, LLC (Business Services)	Senior Loan (8.5%, Due 3/13)	233	217	217
Digital VideoStream, LLC (Business Services)	Unitranche Debt (11.0%, Due 2/12)	17,213	17,128	17,128
	Convertible Subordinated Debt (10.0%, Due 2/16)	4,118	4,103	5,397
DirectBuy Holdings, Inc. (Consumer Products)	Subordinated Debt (14.5%, Due 5/13)	75,000	74,631	74,631
	Equity Interests		8,000	8,000
Distant Lands Trading Co. (Consumer Products)	Senior Loan (10.3%, Due 11/11)	10,000	9,966	9,966
	Unitranche Debt (11.0%, Due 11/11)	42,375	42,226	42,226
	Common Stock (4,000 shares)		4,000	2,645
Driven Brands, Inc.	Senior Loan (8.7%, Due 6/11)	37,070	36,951	36,951

d/b/a Meineke and Econo Lube (Consumer Services)	Subordinated Debt (12.1%, Due 6/12 6/13)	83,000	82,754	82,754
	Common Stock (11,675,331 shares)[12]		29,455	15,977
	Warrants[12]			
Dryden XVIII Leveraged Loan 2007 Limited[4] (CDO/CLO)	Subordinated Debt (9.7%, Due 10/19)	9,000	7,406	7,406
	Income Notes (14.2%)[11]		21,940	21,940
Dynamic India Fund IV [4][5] (Private Equity Fund)	Equity Interests		6,050	6,215
EarthColor, Inc. (Business Services)	Subordinated Debt (15.0%, Due 11/13)	127,000	126,463	126,463
	Common Stock (73,540 shares)[12]		73,540	62,675
	Warrants[12]			
eCentury Capital Partners, L.P.[5] (Private Equity Fund)	Limited Partnership Interest		6,899	2,176
eInstruction Corporation (Education Services)	Subordinated Debt (13.5%, Due 7/14-1/15)	47,000	46,765	46,765
	Common Stock (2,406 shares)		2,500	2,500

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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.
(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 from companies less than 5% owned in the consolidated statement of operations.
(12) Common stock is non-voting. In addition to non-voting stock ownership, the Company has an option to acquire a majority of the voting securities of the portfolio company at fair market value.

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

Private Finance Portfolio Company (in thousands, except number of shares)	Investment[1][2]	December 31, 2007 Principal	Cost	Value
Farley s & Sathers Candy Company, Inc. (Consumer Products)	Subordinated Debt (13.7%, Due 3/11)	$ 18,000	$ 17,932	$ 17,932
FCP-BHI Holdings, LLC d/b/a Bojangles (Consumer Products)	Subordinated Debt (12.8%, Due 9/13)	24,000	23,887	23,887
	Equity Interests		1,000	998
Fidus Mezzanine Capital, L.P.[5] (Private Equity Fund)	Limited Partnership Interest		6,357	6,357
Frozen Specialties, Inc. (Consumer Products)	Warrants		435	229
Garden Ridge Corporation (Retail)	Subordinated Debt (7.0%, Due 5/12)[6]	20,500	20,500	20,500
Geotrace Technologies, Inc. (Energy Services)	Subordinated Debt (10.0%, Due 6/09)	6,772	6,616	6,616
	Warrants		2,350	2,993
Gilchrist & Soames, Inc. (Consumer Products)	Senior Loan (9.0%, Due 10/13)	20,000	19,954	19,954
	Subordinated Debt (13.4%, Due 10/13)	25,800	25,676	25,676
Grotech Partners, VI, L.P.[5] (Private Equity Fund)	Limited Partnership Interest		8,808	8,252
Havco Wood Products LLC (Industrial Products)	Senior Loan (9.7%, Due 8/11)	600	585	585
	Unitranche Debt (11.5%, Due 8/11)	5,100	4,248	4,248
	Equity Interests		1,055	3,192
Haven Eldercare of New England, LLC (Healthcare Services)	Subordinated Debt (12.0%, Due 8/09)[6]	1,927	1,927	
Higginbotham Insurance Agency, Inc. (Business Services)	Senior Loan (7.7%, Due 8/12)	15,033	14,942	14,942
	Subordinated Debt (13.5%, Due 8/13 8/14)	46,356	46,136	46,136
	Common Stock (23,926 shares)[12]		23,926	23,868

	Warrant[12]			
The Hillman Companies, Inc.[3] (Consumer Products)	Subordinated Debt (10.0%, Due 9/11)	44,580	44,458	44,458
The Homax Group, Inc. (Consumer Products)	Senior Loan (8.7%, Due 10/12)	10,969	10,969	10,969
	Subordinated Debt (12.0%, Due 4/14)	14,000	13,244	13,244
	Preferred Stock (89 shares)		89	13
	Common Stock (28 shares)		6	
	Warrants		1,106	194
Ideal Snacks Corporation (Consumer Products)	Senior Loan (9.0%, Due 6/10)	288	288	288
Integrity Interactive Corporation (Business Services)	Unitranche Debt (10.5%, Due 2/12)	12,193	12,095	12,095
International Fiber Corporation (Industrial Products)	Subordinated Debt (14.0%, Due 6/12)	24,572	24,476	24,476
	Preferred Stock (25,000 shares)		2,500	2,194

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(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)

Private Finance Portfolio Company (in thousands, except number of shares)	Investment[1][2]	December 31, 2007 Principal	Cost	Value
Jones Stephens Corporation (Consumer Products)	Senior Loan (8.8%, Due 9/12)	$ 5,537	$ 5,525	$ 5,525
Knightsbridge CLO 2007-1 Limited[4] (CDO/CLO)	Subordinated Debt (14.1%, Due 1/22)	22,000	22,000	22,000
	Income Notes (15.2%)[11]		31,211	31,211
Kodiak Fund LP[5] (Private Equity Fund)	Equity Interests		9,423	2,853
Line-X, Inc. (Consumer Products)	Senior Loan (12.0%, Due 8/11)	900	885	885
	Unitranche Debt (12.0% Due 8/11)	48,198	48,039	42,784
	Standby Letter of Credit ($1,500)			
MedAssets, Inc.[3] (Business Services)	Common Stock (224,817 shares)		2,049	6,652
Mid-Atlantic Venture Fund IV, L.P.[5] (Private Equity Fund)	Limited Partnership Interest		6,975	1,791
Milestone AV Technologies, Inc. (f/k/a CSAV, Inc.) (Business Services)	Subordinated Debt (11.3%, Due 6/13)	37,500	37,500	36,750
NetShape Technologies, Inc. (Industrial Products)	Senior Loan (8.6%, Due 2/13)	5,802	5,773	5,773
Network Hardware Resale, Inc. (Business Services)	Unitranche Debt (10.5%, Due 12/11)	20,512	20,614	20,614
	Convertible Subordinated Debt (9.8%, Due 12/15)	13,242	13,302	15,586
Norwesco, Inc. (Industrial Products)	Subordinated Debt (12.7%, Due 1/12 7/12)	82,924	82,674	82,674
	Common Stock (559,603 shares)[12]		38,313	117,831
	Warrants[12]			
Novak Biddle Venture Partners III, L.P.[5] (Private Equity Fund)	Limited Partnership Interest		1,910	1,256

Oahu Waste Services, Inc. (Business Services)	Stock Appreciation Rights		239	998
Odyssey Investment Partners Fund III, LP[5] (Private Equity Fund)	Limited Partnership Interest		2,276	2,567
Pangaea CLO 2007-1 Ltd.[4] (CDO/CLO)	Subordinated Debt (10.2%, Due 10/21)	15,000	11,570	11,570
Passport Health Communications, Inc. (Healthcare Services)	Preferred Stock (651,381 shares)		2,000	2,433
	Common Stock (19,680 shares)		48	7
PC Helps Support, LLC (Business Services)	Senior Loan (8.9%, Due 12/13)	20,000	20,000	20,000
	Subordinated Debt (13.3%, Due 12/13)	30,895	30,743	30,743
Pendum, Inc. (Business Services)	Subordinated Debt (17.0%, Due 1/11)[6]	34,028	34,028	
	Preferred Stock (82,715 shares)			
	Warrants			
Performant Financial Corporation (Business Services)	Common Stock (478,816 shares)		734	

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(3) Public company.

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

(11) Represents the effective interest yield earned on the cost basis of these preferred equity investments and income notes. The yield is included in interest income from companies less than 5% owned 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]	December 31, 2007 Principal	Cost	Value
PharMEDium Healthcare Corporation (Healthcare Services)	Senior Loan (8.6%, Due 10/13)	$ 19,577	$ 19,577	$ 19,577
Postle Aluminum Company, LLC (Industrial Products)	Unitranche Debt (11.0%, Due 10/12)	61,500	61,252	61,252
	Equity Interests		2,500	3,092
Pro Mach, Inc. (Industrial Products)	Subordinated Debt (13.0%, Due 6/12)	14,562	14,506	14,506
	Equity Interests		1,500	1,596
Promo Works, LLC (Business Services)	Unitranche Debt (10.3%, Due 12/11)	26,215	26,006	26,006
	Guaranty ($600)			
Reed Group, Ltd. (Healthcare Services)	Senior Loan (8.7%, Due 12/13)	21,000	20,970	20,970
	Subordinated Debt (13.8%, Due 12/13)	18,000	17,910	17,910
	Equity Interests		1,800	1,800
S.B. Restaurant Company (Retail)	Unitranche Debt (9.8%, Due 4/11)	34,001	33,733	33,733
	Preferred Stock (54,125 shares)		135	135
	Warrants		619	2,095
	Standby Letters of Credit ($2,540)			
SBBUT, LLC (Consumer Products)	Equity Interests			
Service Center Metals, LLC (Industrial Products)	Subordinated Debt (15.5%, Due 9/11)	5,000	4,981	4,981
	Equity Interests		313	343
Snow Phipps Group, L.P.[5] (Private Equity Fund)	Limited Partnership Interest		2,288	2,288
SPP Mezzanine Funding, L.P.[5] (Private Equity Fund)	Limited Partnership Interest		2,268	1,942
SPP Mezzanine Funding II, L.P.[5] (Private Equity Fund)	Limited Partnership Interest		4,077	3,731
Stag-Parkway, Inc. (Business Services)	Unitranche Debt (10.8%, Due 7/12)	51,000	50,810	50,810

STS Operating, Inc. (Industrial Products)	Subordinated Debt (11.0%, Due 1/13)	30,386	30,273	30,273
Summit Energy Services, Inc. (Business Services)	Senior Loan (8.5%, Due 8/13)	24,239	24,239	23,512
	Subordinated Debt (11.6%, Due 8/13)	35,765	35,596	35,596
	Common Stock (89,406 shares)		2,000	1,995
Tappan Wire and Cable Inc. (Business Services)	Unitranche Debt (15.0%, Due 8/14)	24,100	23,975	23,975
	Common Stock (15,000 shares)(12)		2,250	5,810
	Warrant(12)			
The Step2 Company, LLC (Consumer Products)	Unitranche Debt (11.0%, Due 4/12)	96,041	95,693	95,693
	Equity Interests		2,483	2,987
Tradesmen International, Inc. (Business Services)	Subordinated Debt (12.0%, Due 12/12)	49,124	48,431	48,431
TransAmerican Auto Parts, LLC (Consumer Products)	Subordinated Debt (14.0%, Due 11/12)	24,076	23,907	23,907
	Equity Interests		1,198	1,014
Trover Solutions, Inc. (Business Services)	Subordinated Debt (12.0%, Due 11/12)	60,000	59,740	59,740
Universal Air Filter Company (Industrial Products)	Subordinated Debt (12.0%, Due 11/12)	14,750	14,688	14,688

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

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

Private Finance Portfolio Company (in thousands, except number of shares)	**Investment[1][2]**	**December 31, 2007 Principal**	**Cost**	**Value**
Updata Venture Partners II, L.P.[5] (Private Equity Fund)	Limited Partnership Interest		$ 4,465	$ 4,306
Venturehouse-Cibernet Investors, LLC (Business Services)	Equity Interest			54
Venturehouse Group, LLC[5] (Private Equity Fund)	Equity Interest			613
VICORP Restaurants, Inc. (Retail)	Warrants		33	
Walker Investment Fund II, LLLP[5] (Private Equity Fund)	Limited Partnership Interest		1,330	
WMA Equity Corporation and Affiliates	Subordinated Debt (13.6%, Due 4/13)	$ 125,000	124,010	124,010
d/b/a Wear Me Apparel	Subordinated Debt (9.0%, Due 4/14)[6]	13,033	13,033	13,302
(Consumer Products)	Common Stock (100 shares)		46,046	13,726
Webster Capital II, L.P.[5] (Private Equity Fund)	Limited Partnership Interest		897	897
Woodstream Corporation	Subordinated Debt (12.0%, Due 2/15)	90,000	89,574	89,574
(Consumer Products)	Common Stock (7,500 shares)		7,500	7,482
York Insurance Services Group, Inc.	Subordinated Debt (14.5%, Due 1/14)	45,141	44,966	44,966
(Business Services)	Common Stock (15,000 shares)		1,500	1,995
Other companies	Other debt investments	159	57	62
	Other equity investments		8	
Total companies less than 5% owned			$ 2,994,880	$ 2,990,732

Total private finance (156 portfolio investments)	$ 5,043,882	$ 4,659,321

(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.

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

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

	Interest Rate Ranges	Number of Loans	December 31, 2007 Cost	Value
Commercial Mortgage Loans				
	Up to 6.99%	3	$ 20,361	$ 19,842
	7.00% 8.99%	8	22,768	22,768
	9.00% 10.99%	3	8,372	8,372
	11.00% 12.99%	1	10,456	10,456
	15.00% and above	2	3,970	3,970
Total commercial mortgage loans(13)		17	$ 65,927	$ 65,408
Real Estate Owned			$ 15,272	$ 21,253
Equity Interests(2) Companies more than 25% owned			$ 15,743	$ 34,539
Guarantees ($6,871)				
Standby Letter of Credit ($1,295)				
Total commercial real estate finance			$ 96,942	$ 121,200
Total portfolio			$ 5,140,824	$ 4,780,521

	Yield	Cost	Value
Liquidity Portfolio(14)			
American Beacon Money Market Select FD Fund	4.5%	$ 126,910	$ 126,910
American Beacon Money Market Fund	4.8%	40,163	40,163
SEI Daily Income Tr Prime Obligation Money Market Fund	4.9%	34,143	34,143
Total liquidity portfolio		$ 201,216	$ 201,216
Other Investments in Money Market Securities(14)			
Columbia Treasury Reserves Money Market Fund	4.6%	$ 6	$ 6

(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.

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(13) Commercial mortgage loans totaling $14.3 million at value were on non-accrual status and therefore were considered non-income producing.

(14) Included in investments in money market and other securities on the accompanying Consolidated Balance Sheet.

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF INVESTMENTS

Private Finance Portfolio Company (in thousands, except number of shares)	Investment[(1)(2)]	December 31, 2006 Principal	Cost	Value
Companies More Than 25% Owned				
Alaris Consulting, LLC	Senior Loan (16.5%, Due 12/05 12/07)[(6)]	$ 27,055	$ 26,987	$
(Business Services)	Equity Interests		5,305	
	Guaranty ($1,100)			
Avborne, Inc.[(7)]	Preferred Stock (12,500 shares)		610	918
(Business Services)	Common Stock (27,500 shares)			
Avborne Heavy Maintenance, Inc.[(7)]	Preferred Stock (1,568 shares)		2,401	
(Business Services)	Common Stock (2,750 shares)			
	Guaranty ($2,401)			
Border Foods, Inc.	Preferred Stock (100,000 shares)		12,721	
(Consumer Products)	Common Stock (148,838 shares)		3,848	
Calder Capital Partners, LLC[(5)]	Senior Loan (8.0%, Due 5/09)[(6)]	975	975	975
(Financial Services)	Equity Interests		2,076	2,076
Callidus Capital Corporation	Subordinated Debt (18.0%, Due 10/08)	5,762	5,762	5,762
(Financial Services)	Common Stock (100 shares)		2,058	22,550
Ciena Capital LLC (f/k/a Business Loan Express, LLC)	Class A Equity Interests(25.0%)[(6)]	66,622	66,622	66,622
(Financial Services)	Class B Equity Interests		119,436	79,139
	Class C Equity Interests		109,301	64,976
	Guaranty ($189,706 See Note 3)			
	Standby Letters of Credit ($25,000 See Note 3)			
Coverall North America, Inc.	Unitranche Debt (12.0%, Due 7/11)	36,500	36,333	36,333
(Business Services)	Subordinated Debt (15.0%, Due 7/11)	6,000	5,972	5,972
	Common Stock (884,880 shares)		16,649	19,619
CR Brands, Inc.	Subordinated Debt (16.6%, Due 2/13)	39,573	39,401	39,401
(Consumer Products)	Common Stock (37,200,551 shares)		33,321	25,738

Financial Pacific Company	Subordinated Debt (17.4%, Due 2/12 8/12)	71,589	71,362	71,362
(Financial Services)	Preferred Stock (10,964 shares)		10,276	15,942
	Common Stock (14,735 shares)		14,819	65,186
ForeSite Towers, LLC (Tower Leasing)	Equity Interests		7,620	12,290
Global Communications, LLC	Senior Loan (10.7%, Due 9/02 11/07)(6)	15,957	15,957	15,957
(Business Services)	Subordinated Debt (17.0%, Due 12/03 9/05)(6)	11,339	11,336	11,237
	Preferred Equity Interest		14,067	
	Options		1,639	
Gordian Group, Inc.	Senior Loan (10.0%, Due 6/06 12/08)(6)	11,792	11,803	
(Business Services)	Common Stock (1,000 shares)		6,762	

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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, 2006 Principal**	**Cost**	**Value**
Healthy Pet Corp.	Senior Loan (9.9%, Due 8/10)	$ 27,038	$ 27,038	$ 27,038
(Consumer Services)	Subordinated Debt (15.0%, Due 8/10)	43,720	43,579	43,579
	Common Stock (30,142 shares)		30,142	28,921
HMT, Inc.	Preferred Stock (554,052 shares)		2,637	2,637
(Energy Services)	Common Stock (300,000 shares)		3,000	8,664
	Warrants		1,155	3,336
Huddle House, Inc.	Senior Loan (8.9%, Due 12/11)	19,950	19,950	19,950
(Retail)	Subordinated Debt (15.0%, Due 12/12)	58,484	58,196	58,196
	Common Stock (415,328 shares)		41,662	41,662
Impact Innovations Group, LLC (Business Services)	Equity Interests in Affiliate			873
Insight Pharmaceuticals Corporation	Subordinated Debt (16.1%, Due 9/12)	60,049	59,850	59,850
(Consumer Products)	Preferred Stock (25,000 shares)		25,000	7,845
	Common Stock (620,000 shares)		6,325	
Jakel, Inc.	Subordinated Debt (15.5%, Due 3/08)[6]	15,192	15,192	6,655
(Industrial Products)	Preferred Stock (6,460 shares)		6,460	
	Common Stock (158,061 shares)		9,347	
Legacy Partners Group, LLC	Senior Loan (14.0%, Due 5/09)[6]	7,646	7,646	4,843
(Financial Services)	Subordinated Debt (18.0%, Due 5/09)[6]	2,952	2,952	
	Equity Interests		4,248	
Litterer Beteiligungs-GmbH[4]	Subordinated Debt (8.0%, Due 3/07)	692	692	692
(Business Services)	Equity Interest		1,809	1,199
Mercury Air Centers, Inc.	Subordinated Debt (16.0%, Due 4/09 11/12)	49,358	49,217	49,217
(Business Services)	Common Stock (57,970 shares)		35,053	195,019
	Standby Letters of Credit ($1,581)			

MVL Group, Inc. (Business Services)	Senior Loan (12.0%, Due 6/09 7/09)	27,299	27,245	27,245
	Subordinated Debt (14.5%, Due 6/09)	35,846	35,478	35,478
	Common Stock (648,661 shares)		643	
Penn Detroit Diesel Allison, LLC (Business Services)	Subordinated Debt (15.5%, Due 8/13)	38,173	37,994	37,994
	Equity Interests		21,128	25,949
Powell Plant Farms, Inc. (Consumer Products)	Senior Loan (15.0%, Due 12/07)(6)	35,040	26,192	26,192
	Subordinated Debt (20.0%, Due 6/03)(6)	19,291	19,223	962
	Preferred Stock (1,483 shares)			
	Warrants			
Service Champ, Inc. (Business Services)	Subordinated Debt (15.5%, Due 4/12)	27,733	27,619	27,619
	Common Stock (63,888 shares)		13,662	16,786

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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, 2006 Principal	Cost	Value
Staffing Partners Holding Company, Inc. (Business Services)	Subordinated Debt (13.5%, Due 1/07)[6]	$ 540	$ 540	$ 486
Startec Global Communications Corporation	Senior Loan (10.0%, Due 5/07 5/09)	15,965	15,965	15,965
(Telecommunications)	Common Stock (19,180,000 shares)		37,256	11,232
Sweet Traditions, LLC	Senior Loan (9.0%, Due 8/11)	39,022	35,172	35,172
(Retail)	Equity Interests		450	450
	Standby Letter of Credit ($120)			
Triview Investments, Inc.[8]	Senior Loan (9.6%, Due 6/07 12/07)	14,758	14,747	14,747
(Broadcasting & Cable/Business Services/Consumer Products)	Subordinated Debt (16.0%, Due 9/11 7/12)	56,288	56,008	56,008
	Subordinated Debt (7.9%, Due 11/07 7/08)[6]	4,327	4,327	4,342
	Common Stock (202 shares)		98,604	31,322
	Guaranty ($800)			
	Standby Letter of Credit ($200)			
Total companies more than 25% owned			$ 1,578,822	$ 1,490,180
Companies 5% to 25% Owned				
Advantage Sales & Marketing, Inc.	Subordinated Debt (12.0%, Due 3/14)	$ 152,320	$ 151,648	$ 151,648
(Business Services)	Equity Interests			11,000
Air Medical Group Holdings LLC	Senior Loan (9.9%, Due 3/11)	1,828	1,763	1,763
(Healthcare Services)	Subordinated Debt (14.0%, Due 11/12)	35,180	35,128	35,128
	Equity Interests		3,470	5,950
Alpine ESP Holdings, Inc.	Preferred Stock (622 shares)		622	602
(Business Services)	Common Stock (13,513 shares)		14	

Amerex Group, LLC	Subordinated Debt (12.0%, Due 1/13)	8,400	8,400	8,400
(Consumer Products)	Equity Interests		3,546	13,823
BB&T Capital Partners/Windsor Mezzanine Fund, LLC (5) (Private Equity Fund)	Equity Interests		5,873	5,554
Becker Underwood, Inc.	Subordinated Debt (14.5%, Due 8/12)	24,244	24,163	24,163
(Industrial Products)	Common Stock (5,073 shares)		5,813	3,700
BI Incorporated	Subordinated Debt (13.5%, Due 2/14)	30,269	30,135	30,135
(Business Services)	Common Stock (40,000 shares)		4,000	4,100

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(8) Triview Investments, Inc. holds investments in Longview Cable & Data, LLC (Broadcasting & Cable) with a cost of $67.3 million and a value of $7.5 million, Triax Holdings, LLC (Consumer Products) with a cost of $98.9 million and a value of $91.5 million, and Crescent Hotels & Resorts, LLC and affiliates (Business Services) with a cost of $7.5 million and a value of $7.3 million.

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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, 2006 Principal	Cost	Value
CitiPostal, Inc. and Affiliates	Senior Loan (11.1%, Due 8/13-11/14)	$ 20,670	$ 20,569	$ 20,569
(Business Services)	Equity Interests		4,447	4,700
Creative Group, Inc.	Subordinated Debt (12.0%, Due 9/13)	15,000	13,656	13,656
(Business Services)	Warrant		1,387	1,387
Drew Foam Companies, Inc.	Preferred Stock (722 shares)		722	722
(Business Services)	Common Stock (7,287 shares)		7	7
MedBridge Healthcare, LLC	Senior Loan (6.0%, Due 8/09)[6]	7,164	7,164	7,164
(Healthcare Services)	Subordinated Debt (10.0%, Due 8/14)[6]	5,184	5,184	1,813
	Convertible Subordinated Debt (2.0%, Due 8/14)[6]	2,970	984	
	Equity Interests		1,306	
Multi-Ad Services, Inc.	Unitranche Debt (11.3%, Due 11/11)	20,000	19,879	19,879
(Business Services)	Equity Interests		2,000	2,000
Nexcel Synthetics, LLC	Subordinated Debt (14.5%, Due 6/09)	10,998	10,978	10,978
(Consumer Products)	Equity Interests		1,755	1,486
PresAir LLC	Senior Loan (7.5%, Due 12/10)[6]	5,810	5,492	2,206
(Industrial Products)	Equity Interests		1,336	
Progressive International Corporation	Subordinated Debt (16.0%, Due 12/09)	7,553	7,533	7,533
(Consumer Products)	Preferred Stock (500 shares)		500	1,024
	Common Stock (197 shares)		13	2,300
	Warrants			
Regency Healthcare Group, LLC	Senior Loan (11.1%, Due 6/12)	1,250	1,232	1,232
(Healthcare Services)	Unitranche Debt (11.1%, Due 6/12)	20,000	19,908	19,908
	Equity Interests		1,500	1,616

SGT India Private Limited[4] (Business Services)	Common Stock (109,524 shares)		3,944	3,346
Soteria Imaging Services, LLC	Subordinated Debt (11.6%, Due 11/10)	18,500	17,569	17,569
(Healthcare Services)	Equity Interests		2,163	2,541
Universal Environmental Services, LLC	Unitranche Debt (14.5%, Due 2/09)	10,989	10,962	10,211
(Business Services)	Equity Interests		1,795	
Total companies 5% to 25% owned			$ 438,560	$ 449,813
Companies Less Than 5% Owned				
3SI Security Systems, Inc.	Subordinated Debt (14.5%, Due 8/13)	$ 26,857	$ 26,740	$ 26,740
(Consumer Products)				
AgData, L.P. (Consumer Services)	Unitranche Debt (10.3%, Due 7/12)	11,330	11,269	11,269
Anthony, Inc. (Industrial Products)	Subordinated Debt (13.3%, Due 8/11 9/12)	14,818	14,768	14,768
Axium Healthcare Pharmacy, Inc.	Senior Loan (12.0%, Due 12/12)	200	161	161
(Healthcare Services)	Unitranche Debt (12.0%, Due 12/12)	9,000	8,956	8,956
	Common Stock (26,500 shares)		2,650	2,650
Baird Capital Partners IV Limited Partnership[5] (Private Equity Fund)	Limited Partnership Interest		876	876

(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.
(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, 2006 Principal	Cost	Value
Bantek West, Inc. (Business Services)	Subordinated Debt (11.6%, Due 1/11)[(6)]	$ 30,000	$ 30,000	$ 21,463
Benchmark Medical, Inc. (Healthcare Services)	Warrants		18	
BenefitMall, Inc. (Business Services)	Unitranche Debt (13.3%, Due 8/12)	110,030	109,648	109,648
	Common Stock (45,528,000 shares)[(11)]		45,528	43,578
	Warrants[(11)]			
	Standby Letters of Credit ($9,981)			
Breeze-Eastern Corporation[(3)] (Industrial Products)	Senior Loan (10.1%, Due 5/11)	10,000	10,000	10,000
Broadcast Electronics, Inc. (Business Services)	Senior Loan (9.1%, Due 7/12)	4,963	4,930	4,930
C&K Market, Inc. (Retail)	Subordinated Debt (14.0%, Due 12/08)	27,819	27,738	27,738
Callidus Debt Partners CDO Fund I, Ltd. [(4)(9)] (CDO/CLO)	Class C Notes (12.9%, Due 12/13)	18,800	18,951	18,951
	Class D Notes (17.0%, Due 12/13)	9,400	9,476	9,476
Callidus Debt Partners CLO Fund III, Ltd.[(4)(9)] (CDO/CLO)	Preferred Shares (23,600,000 shares, 12.7%) [(12)]		23,285	23,010
Callidus Debt Partners CLO Fund IV, Ltd. [(4)(9)] (CDO/CLO)	Income Notes (13.8%)[(12)]		12,986	12,986
Callidus Debt Partners CLO Fund V, Ltd.[(4)(9)] (CDO/CLO)	Income Notes (15.8%)[(12)]		13,769	13,769
	Class E Notes (10.9%, Due 12/17)	17,000	17,000	17,155

Callidus MAPS CLO Fund I LLC(9) (CDO/CLO)	Income Notes (15.9%)(12)		50,960	47,421
Camden Partners Strategic Fund II, L.P.(5) (Private Equity Fund)	Limited Partnership Interest		2,141	2,873
Carlisle Wide Plank Floors, Inc. (Consumer Products)	Unitranche Debt (10.5%, Due 6/11)	14,000	13,900	13,900
	Preferred Stock (400,000 Shares)		400	400
Catterton Partners V, L.P.(5) (Private Equity Fund)	Limited Partnership Interest		3,306	3,412
Catterton Partners VI, L.P.(5) (Private Equity Fund)	Limited Partnership Interest		531	531
Centre Capital Investors IV, L.P.(5) (Private Equity Fund)	Limited Partnership Interest		1,991	1,889

(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.

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

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

(11) 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.

(12) Represents the effective yield earned on these preferred equity investments. The yield is included in interest income from companies less than 5% owned 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]	December 31, 2006 Principal	Cost	Value
Commercial Credit Group, Inc. (Financial Services)	Subordinated Debt (14.8%, Due 2/11)	$ 5,000	$ 4,959	$ 4,959
	Preferred Stock (32,500 shares)		3,900	3,900
	Warrants			
Community Education Centers, Inc. (Education Services)	Subordinated Debt (16.0%, Due 12/10)	34,158	34,067	34,067
Compass Group Diversified Holdings LLC[3] (Financial Services)	Senior Loan (8.4%, Due 11/11)	8,500	8,375	8,375
Component Hardware Group, Inc. (Industrial Products)	Subordinated Debt (13.5%, Due 1/13)	18,158	18,075	18,075
Cook Inlet Alternative Risk, LLC (Business Services)	Unitranche Debt (10.0%, Due 4/12)	67,500	67,146	67,146
	Equity Interests		2,000	2,300
Cortec Group Fund IV, L.P.[5] (Private Equity)	Limited Partnership Interest		1,137	1,137
CSAV, Inc. (Business Services)	Subordinated Debt (11.9%, Due 6/13)	37,500	37,500	37,500
DCWV Acquisition Corporation (Consumer Products)	Senior Loan (8.9%, Due 7/12)	2,074	2,060	2,060
	Unitranche Debt (11.0%, Due 7/12)	16,788	16,694	16,694
Deluxe Entertainment Services Group, Inc. (Business Services)	Subordinated Debt (13.6%, Due 7/11)	30,000	30,000	30,000
Distant Lands Trading Co. (Consumer Products)	Senior Loan (10.6%, Due 11/11)	2,700	2,656	2,656
	Unitranche Debt (11.0%, Due 11/11)	54,375	54,130	54,130
	Common Stock (4,000 shares)		4,000	2,975
Drilltec Patents & Technologies Company, Inc.	Subordinated Debt (18.0%, Due 8/06)	4,119	4,119	4,119

(Energy Services)	Subordinated Debt (16.5%, Due 8/06)(6)	10,994	10,918	9,121
Driven Brands, Inc.	Senior Loan (8.9%, Due 6/11)	37,070	36,918	36,918
d/b/a Meineke and Econo Lube	Subordinated Debt (12.1%, Due 6/12 6/13)	83,000	82,684	82,684
(Consumer Services)	Common Stock (11,675,331 shares)(11)		29,455	19,702
	Warrants(11)			
Digital VideoStream, LLC	Unitranche Debt (11.0%, Due 2/12)	19,127	19,021	19,021
(Business Services)	Convertible Subordinated Debt (10.0%, Due 2/16)	3,730	3,714	3,714
Dynamic India Fund IV(4)(5) (Private Equity Fund)	Equity Interests		3,850	3,850
EarthColor, Inc.	Senior Loan (7.4%, Due 11/11)	35,000	35,000	35,000
(Business Services)	Subordinated Debt (15.0%, Due 11/13)	107,000	106,478	106,478
	Common Stock (53,540 shares)(11)		53,540	53,540
	Warrants(11)			
eCentury Capital Partners, L.P.(5) (Private Equity Fund)	Limited Partnership Interest		6,274	2,090

(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.

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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.

(11) 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, 2006 Principal	Cost	Value
Elexis Beta GmbH[4] (Industrial Products)	Options		$ 426	$ 50
Farley s & Sathers Candy Company, Inc. (Consumer Products)	Subordinated Debt (11.4%, Due 3/11)	$ 20,000	19,931	19,931
Frozen Specialties, Inc. (Consumer Products)	Warrants		435	320
Garden Ridge Corporation (Retail)	Subordinated Debt (7.0%, Due 5/12)[6]	22,500	22,500	22,500
Geotrace Technologies, Inc. (Energy Services)	Subordinated Debt (10.0%, Due 6/09)	23,945	22,481	22,481
	Warrants		2,350	1,900
Ginsey Industries, Inc. (Consumer Products)	Subordinated Debt (12.5%, Due 3/07)	2,743	2,743	2,743
Grant Broadcasting Systems II (Broadcasting & Cable)	Subordinated Debt (5.0%, Due 6/11)	3,005	3,005	3,005
Grotech Partners, VI, L.P.[5] (Private Equity Fund)	Limited Partnership Interest		8,223	6,088
Havco Wood Products LLC (Industrial Products)	Unitranche Debt (11.1%, Due 8/11)	19,654	18,615	18,615
	Equity Interests		1,049	3,000
Haven Eldercare of New England, LLC [10] (Healthcare Services)	Subordinated Debt (12.0%, Due 8/09)	2,827	2,827	2,827
Haven Healthcare Management, LLC[10] (Healthcare Services)	Subordinated Debt (18.0%, Due 4/07)	140	140	140
HealthASPex Services Inc. (Business Services)	Senior Loan (4.0%, Due 7/08)	500	500	500
The Hillman Companies, Inc.[3]	Subordinated Debt (10.0%, Due 9/11)	44,580	44,427	44,427

(Consumer Products)				
The Homax Group, Inc. (Consumer Products)	Senior Loan (9.2%, Due 10/12)	12,485	12,485	12,485
	Subordinated Debt (12.0%, Due 4/14)	14,000	13,171	13,171
	Preferred Stock (89 shares)		89	89
	Common Stock (28 shares)		6	6
	Warrants		1,106	1,106
Hot Stuff Foods, LLC (Consumer Products)	Senior Loan (8.9%, Due 2/11-2/12)	48,580	48,351	48,351
	Subordinated Debt (13.7%, Due 8/12 2/13)	60,606	60,353	60,353
	Subordinated Debt (16.0%, Due 2/13)(6)	20,841	20,749	8,460
	Common Stock (1,122,452 shares)(11)		56,186	
	Warrants(11)			
Ideal Snacks Corporation (Consumer Products)	Senior Loan (9.0%, Due 6/10)	5,850	5,815	5,815
Integrity Interactive Corporation (Business Services)	Unitranche Debt (10.5%, Due 2/12)	29,500	29,314	29,314
International Fiber Corporation (Industrial Products)	Subordinated Debt (14.0%, Due 6/12)	21,986	21,914	21,914
	Preferred Stock (25,000 shares)		2,500	2,200

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(10) Haven Eldercare of New England, LLC and Haven Healthcare Management, LLC are affiliated companies.
(11) 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, 2006 Principal**	**Cost**	**Value**
Kodiak Fund LP[5]	Equity Interests		$ 4,700	$ 4,656
(Private Equity Fund)				
Line-X, Inc.	Senior Loan (9.1%, Due 8/11)	$ 2,000	1,981	1,981
(Consumer Products)	Unitranche Debt (10.0% Due 8/11)	48,509	48,306	48,306
	Standby Letter of Credit ($1,500)			
MedAssets, Inc.	Preferred Stock (227,865 shares)		2,049	3,623
(Business Services)	Common Stock (50,000 shares)			250
MHF Logistical Solutions, Inc.	Subordinated Debt (11.5%, Due 6/12)	33,600	33,448	33,448
(Business Services)	Subordinated Debt (18.0%, Due 6/13)[6]	11,211	11,155	8,719
	Common Stock (20,934 shares)[11]		20,942	
	Warrants[11]			
Mid-Atlantic Venture Fund IV, L.P.[5]	Limited Partnership Interest		6,974	3,221
(Private Equity Fund)				
Mogas Energy, LLC	Subordinated Debt (9.5%, Due 3/12 4/12)	16,336	15,100	16,318
(Energy Services)	Warrants		1,774	6,250
Network Hardware Resale, Inc.	Unitranche Debt (10.5%, Due 12/11)	37,154	37,357	37,357
(Business Services)	Convertible Subordinated Debt (9.8%, Due 12/15)	12,000	12,068	12,559
Norwesco, Inc.	Subordinated Debt (12.6%, Due 1/12 7/12)	82,486	82,172	82,172
(Industrial Products)	Common Stock (559,603 shares)[11]		38,313	83,329
	Warrants[11]			
Novak Biddle Venture Partners III, L.P.[5]	Limited Partnership Interest		1,834	1,947
(Private Equity Fund)				
Oahu Waste Services, Inc.	Stock Appreciation Rights		239	800
(Business Services)				

Odyssey Investment Partners Fund III, LP[5] (Private Equity Fund)	Limited Partnership Interest		1,883	1,744
Palm Coast Data, LLC (Business Services)	Senior Loan (8.9%, Due 8/10)	15,306	15,243	15,243
	Subordinated Debt (15.5%, Due 8/12 8/15)	30,396	30,277	30,277
	Common Stock (21,743 shares)[11]		21,743	41,707
	Warrants[11]			
Passport Health Communications, Inc.	Subordinated Debt (14.0%, Due 4/12)	10,145	10,101	10,101
(Healthcare Services)	Preferred Stock (651,381 shares)		2,000	2,189
Performant Financial Corporation (Business Services)	Common Stock (478,816 shares)		734	

(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.

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

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

Private Finance Portfolio Company (in thousands, except number of shares)	Investment(1)(2)	December 31, 2006 Principal	Cost	Value
Postle Aluminum Company, LLC	Unitranche Debt (11.0%, Due 10/12)	$ 57,500	$ 57,189	$ 57,189
(Industrial Products)	Equity Interests		2,500	2,500
Pro Mach, Inc.	Subordinated Debt (12.5%, Due 6/12)	14,471	14,402	14,402
(Industrial Products)	Equity Interests		1,500	2,200
Promo Works, LLC	Unitranche Debt (10.3%, Due 12/11)	31,000	30,727	30,727
(Business Services)	Guaranty ($1,200)			
S.B. Restaurant Company	Unitranche Debt (9.8%, Due 4/11)	41,501	41,094	41,094
(Retail)	Preferred Stock (54,125 shares)		135	135
	Warrants		619	1,200
	Standby Letters of Credit ($2,611)			
SBBUT, LLC	Equity Interests			
(Consumer Products)				
Service Center Metals, LLC	Subordinated Debt (15.5%, Due 9/11)	5,000	4,976	4,976
(Industrial Products)	Equity Interests		312	318
Soff-Cut Holdings, Inc.	Preferred Stock (300 shares)		300	300
(Industrial Products)	Common Stock (2,000 shares)		200	180
SPP Mezzanine Funding, L.P.(5)	Limited Partnership Interest		2,551	2,825
(Private Equity Fund)				
SPP Mezzanine Funding II, L.P.(5)	Limited Partnership Interest		326	326
(Private Equity Fund)				
Stag-Parkway, Inc.	Unitranche Debt (10.8%, Due 7/12)	63,000	62,711	62,711
(Business Services)				
STS Operating, Inc.	Subordinated Debt (15.0%, Due 1/13)	30,156	30,021	30,021
(Industrial Products)				
The Step2 Company, LLC	Unitranche Debt (10.5%, Due 4/12)	67,898	67,457	67,457
(Consumer Products)	Equity Interests		2,000	1,763

Tradesmen International, Inc.	Subordinated Debt (12.0%, Due 12/09)	15,000	14,468	14,468
(Business Services)	Warrants		710	3,300
TransAmerican Auto Parts, LLC	Subordinated Debt (14.0%, Due 11/12)	12,947	12,892	12,892
(Consumer Products)	Equity Interests		1,190	747
Universal Air Filter Company (Industrial Products)	Unitranche Debt (11.0%, Due 11/11)	19,117	19,026	19,026
Updata Venture Partners II, L.P.(5) (Private Equity Fund)	Limited Partnership Interest		5,477	5,158
Venturehouse-Cibernet Investors, LLC (Business Services)	Equity Interest		42	42
Venturehouse Group, LLC(5) (Private Equity Fund)	Equity Interest		598	365
VICORP Restaurants, Inc. (Retail)	Warrants		33	

(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.

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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, 2006 Principal	Cost	Value
Walker Investment Fund II, LLLP[5] (Private Equity Fund)	Limited Partnership Interest		$ 1,329	$ 458
Wear Me Apparel Corporation	Subordinated Debt (15.0%, Due 12/10)	$ 40,000	39,407	39,407
(Consumer Products)	Warrants		1,219	5,120
Wilton Industries, Inc. (Consumer Products)	Subordinated Debt (16.0%, Due 6/08)	2,400	2,400	2,400
Woodstream Corporation	Subordinated Debt (13.5%, Due 11/12 5/13)	53,114	52,989	52,989
(Consumer Products)	Common Stock (180 shares)		673	3,885
	Warrants			2,815
York Insurance Services Group, Inc.	Subordinated Debt (14.5%, Due 1/14)	44,249	44,045	44,045
(Business Services)	Common Stock (15,000 shares)		1,500	1,500
Other companies	Other debt investments[6]	223	223	218
	Other equity investments		8	
Total companies less than 5% owned			$ 2,479,981	$ 2,437,908
Total private finance (145 portfolio investments)			$ 4,497,363	$ 4,377,901

(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.
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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.

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)

	Interest Rate Ranges	Number of Loans	December 31, 2006 Cost	Value
Commercial Mortgage Loans				
	Up to 6.99%	3	$ 20,470	$ 19,692
	7.00% 8.99%	9	24,092	24,073
	9.00% 10.99%	4	24,117	24,117
	15.00% and above	2	3,970	3,970
Total commercial mortgage loans(13)		18	$ 72,649	$ 71,852
Real Estate Owned			$ 15,708	$ 19,660
Equity Interests(2) Companies more than 25% owned (Guarantees $6,871)			$ 15,189	$ 26,671
Total commercial real estate finance			$ 103,546	$ 118,183
Total portfolio			$ 4,600,909	$ 4,496,084

	Yield	Cost	Value
Liquidity Portfolio(14)			
American Beacon Money Market Select FD Fund	5.3%	$ 85,672	$ 85,672
Certificate of Deposit (Due March 2007)	5.6%	40,565	40,565
American Beacon Money Market Fund	5.2%	40,384	40,384
SEI Daily Income Tr Prime Obligation Money Market Fund	5.2%	34,671	34,671
Blackrock Liquidity Funds	5.2%	476	476
Total liquidity portfolio		$ 201,768	$ 201,768
Other Investments in Money Market Securities(14)			
Columbia Treasury Reserves Money Market Fund	5.2%	$ 441	$ 441
Columbia Money Market Reserves	5.2%	$ 1	$ 1

(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.
(13) Commercial mortgage loans totaling $18.9 million at value were on non-accrual status and therefore were considered non-income producing.
(14) Included in investments in money market and other securities on the accompanying Consolidated Balance Sheet.

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Organization

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

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.

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 2006 and 2005 balances to conform with the 2007 financial statement presentation.

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.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2. Summary of Significant Accounting Policies, continued

Valuation Of Portfolio Investments

The Company, as a BDC, has invested in illiquid securities including debt and equity securities of companies, CLO bonds and preferred shares/income notes, and CDO bonds. 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. The Company determines fair value to be the amount for which an investment could be exchanged in an orderly disposition over a reasonable period of time between willing parties other than in a forced or liquidation sale. The Company s valuation policy considers the fact that no ready market exists for substantially all of the securities in which it invests. The Company s valuation policy is intended to provide a consistent basis for determining the fair value of the portfolio. The Company will record unrealized depreciation on investments when it believes that an investment has become impaired, including where collection of a loan or realization of an equity security is doubtful, or when the enterprise value of the portfolio company does not currently support the cost of the Company s debt or equity investments. Enterprise value means the entire value of the company to a potential buyer, including the sum of the values of debt and equity securities used to capitalize the enterprise at a point in time. The Company will record unrealized appreciation if it believes that the underlying portfolio company has appreciated in value and/or the Company s equity security has also appreciated in value. The value of investments in publicly traded securities is determined using quoted market prices discounted for restrictions on resale, if any.

Loans and Debt Securities

The Company s loans and debt securities generally do not trade. The Company typically exits its loans and debt securities upon the sale or recapitalization of the portfolio company. Therefore, the Company generally determines the enterprise value of the portfolio company and then allocates that value to the loans and debt securities in order of the legal priority of contractual obligations, with the remaining value, if any, going to the portfolio company s outstanding equity securities. For loans and debt securities, fair value generally approximates cost unless the borrower s enterprise value, overall financial condition or other factors lead to a determination of fair value at a different amount. The value of loan and debt securities may be greater than the Company s cost basis if the amount that would be repaid on the loan or debt security upon the sale or recapitalization of the portfolio company is greater than the Company s cost basis.

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.

Interest income is recorded on an accrual basis to the extent that such amounts are expected to be collected. For loans and debt securities with contractual payment-in-kind interest, which represents contractual interest accrued and added to the loan balance that generally becomes due at maturity, the Company will not accrue payment-in-kind interest if the portfolio company valuation indicates that the payment-in-kind interest is not collectible. In general, interest is not accrued on loans and debt securities if the Company has doubt about interest collection or where the enterprise value of the portfolio company may not support further accrual. Loans in workout status do not accrue interest. In addition, interest may not accrue on loans or debt securities to portfolio companies that are more than 50% owned by the

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2. Summary of Significant Accounting Policies, continued

Company depending on such company s capital requirements. 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.

Equity Securities

The Company s equity securities in portfolio companies for which there is no liquid public market are valued at fair value based on the enterprise value of the portfolio company, which 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 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.

The value of the Company s equity investments in private debt and equity funds are generally valued at the fund s net asset value. The value of the Company s equity securities in public companies for which market quotations are readily available is based on the closing public market price on the balance sheet date. Securities that carry certain restrictions on sale are typically valued at a discount from the public market value of the security.

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.

Collateralized Loan Obligations (CLO) and Collateralized Debt Obligations (CDO)

CLO bonds and preferred shares/ income notes and CDO bonds (CLO/ CDO Assets) are carried at fair value, which is based on a discounted cash flow model that utilizes prepayment, re-investment and loss assumptions based on historical experience and projected performance, economic factors, the characteristics of the underlying cash flow, and comparable yields for similar bonds and preferred shares/income notes, when available. 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 or loss assumptions in the underlying collateral pool. The Company determines the fair value of its CLO/CDO Assets on an individual security-by-security basis.

The Company recognizes interest income on the preferred shares/income notes using the effective interest method, based on the anticipated yield and 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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2. Summary of Significant Accounting Policies, continued

prepayments and/or re-investments, credit losses 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.

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 year, 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 and deposits of proceeds from sales of borrowed Treasury securities, if any, and depreciation on accrued interest and dividends receivable and other assets where collection is doubtful.

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 are generally recognized as income as the services are rendered.

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 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.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2. Summary of Significant Accounting Policies, continued

Dividends to Shareholders

Dividends to shareholders are recorded on the record 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 related service period in the consolidated statement of operations. The stock option expense for the years ended December 31, 2007 and 2006, was as follows:

($ in millions, except per share amounts)	**2007**	**2006**
Employee Stock Option Expense:		
Options granted:		
Previously awarded, unvested options as of January 1, 2006	$ 10.1	$ 13.2
Options granted on or after January 1, 2006	10.7	2.4
Total options granted	20.8	15.6
Options cancelled in connection with tender offer (see Note 9)	14.4	
Total employee stock option expense	$ 35.2	$ 15.6
Per basic share	$ 0.23	$ 0.11
Per diluted share	$ 0.23	$ 0.11

In addition to the employee stock option expense for options granted, for both the years ended December 31, 2007 and 2006, administrative expense included $0.2 million of expense related to options granted to directors during each year. Options were granted to non-officer directors in the second quarters of 2007 and 2006. Options granted to non-officer directors vest on the grant date and therefore, the full expense is recorded on the grant date.

Prior to January 1, 2006, the Company accounted for this plan under the recognition and measurement principles of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. Prior to January 1, 2006, no stock-based compensation cost was reflected in net increase in net assets resulting from operations, as all options granted under this plan had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net increase in net assets resulting from operations and earnings per share if the Company had

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2. Summary of Significant Accounting Policies, continued

applied the fair value recognition provisions of FASB Statement No. 123, *Accounting for Stock-Based Compensation*, to stock-based compensation for the year ended December 31, 2005.

($ in millions, except per share amounts)		2005
Net increase in net assets resulting from operations as reported	$	872.8
Less total stock-based compensation expense determined under fair value based method for all awards, net of related tax effects		(12.7)
Pro forma net increase in net assets resulting from operations		860.1
Less preferred stock dividends		
Pro forma net income available to common shareholders	$	860.1
Basic earnings per common share:		
As reported	$	6.48
Pro forma	$	6.39
Diluted earnings per common share:		
As reported	$	6.36
Pro forma	$	6.27

Options Granted. The stock option expense for options granted for 2007 and 2006, and the pro forma expense for 2005 shown in the tables above were 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 years ended December 31, 2007, 2006, and 2005:

	2007	2006	2005
Expected term (in years)	5.0	5.0	5.0
Risk-free interest rate	4.6%	4.8%	4.1%
Expected volatility	26.4%	29.1%	35.1%
Dividend yield	8.9%	9.0%	9.0%
Weighted average fair value per option	$ 2.96	$ 3.47	$ 3.94

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 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 the Company s historical dividend yield over a historical time period consistent with the expected term.

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 for outstanding unvested options as of December 31, 2007, will be approximately $9.7 million and $2.8 million for the years ended December 31, 2008 and 2009, respectively. This estimate may change if the Company s assumptions related to future option forfeitures change. This estimate does not include any expense related to stock option grants after December 31,

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2. Summary of Significant Accounting Policies, continued

2007, 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 December 31, 2007, is expected to be recognized over an estimated weighted-average period of 1.0 year.

Options Cancelled in Connection with Tender Offer. As discussed in Note 9, the Company completed a tender offer in July 2007, whereby the Company accepted for cancellation 10.3 million vested options held by employees and non-officer directors of the Company in exchange for an option cancellation payment (OCP). The OCP was equal to the in-the-money value of the stock options cancelled, determined using the Weighted Average Market Price of $31.75, and was paid one-half in cash and one-half in unregistered shares of the Company s common stock. In accordance with the terms of the tender offer, the Weighted Average Market Price represented the volume weighted average price of the Company s common stock over the fifteen trading days preceding the first day of the offer period, or June 20, 2007. Because the Weighted Average Market Price at the commencement of the tender offer on June 20, 2007, was higher than the market price of the Company s common stock at the close of the offer on July 18, 2007, SFAS 123R required the Company to record a non-cash employee-related stock option expense of $14.4 million and administrative expense related to stock options cancelled that were held by non-officer directors of $0.4 million. The same amounts were recorded as an increase to additional paid-in capital and, therefore, had no effect on the Company s net asset value. The portion of the OCP paid in cash of $52.8 million reduced the Company s additional paid-in capital and therefore reduced the Company s net asset value. For income tax purposes, the Company s tax deduction resulting from the OCP will be similar to the tax deduction that would have resulted from an exercise of stock options in the market. Any tax deduction for the Company resulting from the OCP or an exercise of stock options in the market is limited by Section 162(m) of the Internal Revenue Code (Code).

Federal and State Income Taxes and Excise Tax

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

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

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2. Summary of Significant Accounting Policies, continued

Per Share Information

Basic earnings per common share is calculated using the weighted average number of common shares outstanding for the year presented. Diluted earnings per common share reflects the potential dilution that could occur if options to issue common stock were exercised into common stock. Earnings per share is computed after subtracting dividends on preferred shares, if any.

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 $4.8 billion and $4.5 billion at December 31, 2007 and 2006, respectively. At both December 31, 2007 and 2006, 92% 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

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, which clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes.* This interpretation is effective for fiscal years beginning after December 15, 2006. The adoption of this interpretation did not have a significant effect on the Company s consolidated financial position or its results of operations.

In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements.* This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is currently analyzing the effect of adoption of this statement on its consolidated financial position, including its net asset value, and results of operations. The Company will adopt this statement on a prospective basis beginning in the quarter ending March 31, 2008. Adoption of this statement could have a material effect on the Company s consolidated financial statements, including the Company s net asset value. However, the actual impact on its consolidated financial statements in the period of adoption and subsequent to the period of adoption cannot be determined at this time as it will be influenced by the estimates of fair value for that period and the number and amount of investments the Company originates, acquires or exits.

In February 2007, the FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115.* This statement 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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2. Summary of Significant Accounting Policies, continued

requirements for assets and liabilities reported at fair value as a consequence of the election. This statement is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company does not intend to elect fair value measurement for assets or liabilities other than portfolio investments, which are already measured at fair value, therefore, the Company does not believe the adoption of this statement will have a significant effect on the Company s consolidated financial position or its results of operations.

Note 3. Portfolio

Private Finance

At December 31, 2007 and 2006, the private finance portfolio consisted of the following:

	2007			2006		
($ in millions)	**Cost**	**Value**	**Yield[1]**	**Cost**	**Value**	**Yield[1]**
Loans and debt securities:						
Senior loans	$ 374.1	344.3	7.7%	$ 450.0	$ 405.2	8.4%
Unitranche debt[2]	659.2	653.9	11.5%	800.0	799.2	11.2%
Subordinated debt	2,576.4	2,416.4	12.8%	2,038.3	1,980.8	12.9%
Total loans and debt securities[3]	3,609.7	3,414.6	12.1%	3,288.3	3,185.2	11.9%
Equity securities:						
Preferred shares/income notes of CLOs[4]	218.3	203.0	14.6%	101.1	97.2	15.5%
Other equity securities	1,215.9	1,041.7		1,108.0	1,095.5	
Total equity securities	1,434.2	1,244.7		1,209.1	1,192.7	
Total	$ 5,043.9	$ 4,659.3		$ 4,497.4	$ 4,377.9	

(1) The weighted average yield on loans and debt securities is computed as the (a) annual stated interest on accruing loans and debt securities 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 December 31, 2007 and 2006, the cost and value of subordinated debt included the Class A equity interests in Ciena Capital LLC, which were placed on non-accrual status during the fourth quarter of 2006.

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.

(2) Unitranche debt is generally in a first lien position.

(3)

The total principal balance outstanding on loans and debt securities was $3,639.6 million and $3,322.3 million at December 31, 2007 and 2006, respectively. The difference between principal and cost is represented by unamortized loan origination fees and costs, original issue discounts, and market discounts totaling $29.9 million and $34.0 million at December 31, 2007 and 2006, respectively.

(4) Investments in the preferred shares/income notes of CLOs 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 are generally issued by private companies and are generally illiquid and may be subject to certain restrictions on resale.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3. Portfolio, continued

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 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 both December 31, 2007 and 2006, 86% of the private finance loans and debt securities had a fixed rate of interest and 14% 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 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. Unitranche debt 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 is generally 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 is generally paid to the Company quarterly.

Equity securities consist primarily 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, in conjunction with its debt investments. The Company may also 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) focuses on loan products that provide financing to commercial real estate owners and operators. Ciena is also 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.

At December 31, 2007, the Company s investment in Ciena totaled $327.8 million at cost and $68.6 million at value, after the effect of unrealized depreciation of $259.2 million. At December 31, 2006, the Company s investment in Ciena totaled $295.3 million at cost and $210.7 million at value, after the effect of unrealized depreciation of $84.6 million. In 2007, the Company increased its investment in Ciena by $32.4 million. The Company acquired $29.2 million in additional Class A equity interests to fund payments to

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3. Portfolio, continued

the SBA discussed below and to provide additional capital to Ciena. In addition, the Company purchased $3.2 million in Class A equity interests from Ciena s former Chief Executive Officer.

Net change in unrealized appreciation or depreciation included a net decrease in the Company s investment in Ciena of $174.5 million and $142.3 million for the years ended December 31, 2007 and 2006, respectively, and a net increase of $2.9 million for the year ended December 31, 2005.

Total interest and related portfolio income earned from the Company s investment in Ciena for the years ended December 31, 2007, 2006, and 2005, was as follows:

($ in millions)	2007	2006	2005
Interest income on subordinated debt and Class A equity interests[1]	$	$ 11.9	$ 14.3
Dividend income on Class B equity interests[1]			14.0
Fees and other income	5.4	7.8	9.2
Total interest and related portfolio income	$ 5.4	$ 19.7	$ 37.5

(1) Interest and dividend income from Ciena for the years ended December 31, 2006 and 2005, included interest and dividend income of $5.7 million and $8.9 million, respectively, which was paid in kind. The interest and dividends paid in kind were paid to the Company through the issuance of additional debt or equity interests.

In the fourth quarter of 2006, the Company placed its investment in Ciena s 25% Class A equity interests on non-accrual status. As a result, there was no interest income from the Company s investment in Ciena for the year ended December 31, 2007, and interest income for 2006 was lower as compared to 2005. In consideration for providing a guaranty on Ciena s revolving credit facility and standby letters of credit (discussed below), the Company earned fees of $5.4 million, $6.1 million, and $6.3 million for the years ended December 31, 2007, 2006, and 2005, respectively, which were included in fees and other income. Ciena has not yet paid the $5.4 million in such fees earned by the Company in 2007. At December 31, 2007, such fees were included as a receivable in other assets. The Company considered this outstanding receivable in its valuation of Ciena at December 31, 2007. The remaining fees and other income in 2006 and 2005 relate to management fees from Ciena. The Company did not charge Ciena management fees in 2007 or in the fourth quarter of 2006.

The Company guarantees Ciena s revolving credit facility that matures in March 2009. On January 30, 2008, Ciena completed an amendment of the terms of its revolving credit facility. The amendment reduced the commitments from the lenders under the facility from $500 million to $450 million at the effective date of the amendment, with further periodic reductions in total commitments to $325 million by December 31, 2008. In addition, certain financial and other covenants were amended. In connection with this amendment, the Company increased its unconditional guarantee from 60% to 100% of the total obligations under this facility (consisting of principal, letters of credit issued under the facility, accrued interest, and other fees) and agreed to replace $42.5 million in letters of credit issued under the Ciena credit facility with new letters of credit under the Company s revolving line of credit. The guaranty of the Ciena revolving credit facility can be called by the lenders in the event of a default, which includes the occurrence of any event of default under the Company s revolving credit facility, subject to grace periods in certain cases. The amendment also prohibits cash payments from Ciena to the Company for interest, guarantee fees, management fees, and dividends. On January 30, 2008, the principal amount outstanding on Ciena s revolving credit facility was $351.9 million and letters of credit issued under the

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3. Portfolio, continued

facility were $89.1 million, of which the Company replaced $42.5 million on January 31, 2008. Following the amendment of the revolving credit facility and the replacement of certain letters of credit by the Company, at January 31, 2008, amounts guaranteed under Ciena s line of credit by the Company were $399.0 million, including $46.6 million of letters of credit issued under the facility. At December 31, 2007, the total obligation guaranteed by the Company was $258.7 million, and the Company had provided four standby letters of credit totaling $18.0 million in connection with four term securitization transactions completed by Ciena.

Ciena relies on the asset-backed securitization market to finance its loan origination activity. That financing source is an unreliable one in the current capital markets, and as a result, Ciena has significantly curtailed loan origination activity, including loan originations under the SBA s 7(a) Guaranteed Loan Program. Ciena continues to reposition its business. However, there is an inherent risk in this repositioning and the Company continues to work with Ciena on restructuring. Ciena maintains two non-recourse securitization warehouse facilities, and there is no assurance that Ciena will be able to refinance these facilities in the term securitization market. 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 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. Specifically, on or about January 9, 2007, Ciena became aware of an indictment captioned as the United States v. Harrington, No. 2:06-CR-20662 pending in the United States District Court for the Eastern District of Michigan. The indictment alleged that a former Ciena employee in the Detroit office engaged in the fraudulent origination of loans guaranteed, in substantial part, by the SBA. The Company understands that Ciena is working cooperatively with the U.S. Attorney s Office and the investigating agencies with respect to this matter. On October 1, 2007, the former Ciena employee pled guilty to one count of conspiracy to fraudulently originate SBA-guaranteed loans and one count of making a false statement before a grand jury. The OIG and the U.S. Department of Justice are also conducting a civil investigation of Ciena s lending practices in various jurisdictions. As an SBA lender, Ciena is also subject to other SBA and OIG audits, investigations, and reviews. In addition, the Office of the Inspector General of the U.S. Department of Agriculture is conducting an investigation of Ciena s lending practices under the Business and Industry Loan (B&I) program. These investigations, audits and reviews are ongoing.

On March 6, 2007, Ciena entered into an agreement with the SBA. According to the agreement, Ciena remains a preferred lender in the SBA 7(a) Guaranteed Loan Program and retains the ability to sell loans into the secondary market. As part of this agreement, Ciena agreed to the immediate payment of approximately $10 million to the SBA to cover amounts paid by the SBA with respect to some of the SBA-guaranteed loans that have been the subject of the charges by the U.S. Attorney s Office for the Eastern District of Michigan against Mr. Harrington. As part of the SBA s increased oversight, the agreement provides that any loans originated and closed by Ciena during the term of the agreement will be reviewed by an independent third party selected by the SBA prior to the sale of such loans into the secondary market. The agreement also requires Ciena to repurchase the guaranteed portion of certain loans that default after having been sold into the secondary market, and subjects such loans to a similar third party review prior to any reimbursement of Ciena by the SBA. In connection with this agreement, Ciena also entered into an escrow agreement with the SBA and an escrow agent in which Ciena agreed to deposit $10 million with the escrow agent for any additional payments Ciena may be obligated to pay to the SBA in the future. Ciena remains subject to SBA rules and regulations and as a result may be required to make additional payments to the SBA in the ordinary course of business.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3. Portfolio, continued

On or about January 16, 2007, Ciena and its subsidiary Business Loan Center LLC (BLC) became aware of a lawsuit titled, United States, ex rel James R. Brickman and Greenlight Capital, Inc. v. Business Loan Express LLC f/k/a Business Loan Express, Inc.; Business Loan Center LLC f/k/a Business Loan Center, Inc.; Robert Tannenhauser; Matthew McGee; and George Harrigan, 05-CV-3147 (JEC). The complaint includes allegations arising under the False Claims Act and relating to alleged fraud in connection with SBA guarantees on shrimp vessel loans. On December 18, 2007, the United States District Court for the Northern District of Georgia dismissed all claims in this matter. In January 2008, the plaintiffs filed a notice of their intention to appeal the dismissal.

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 current regulatory issues, ongoing investigations, litigation, and the repositioning of its business in performing the valuation of Ciena at December 31, 2007. The Company is monitoring the situation.

At December 31, 2007 and 2006, the Company held all of the Class A equity interests, all of the Class B equity interests and 94.9% of the Class C equity interests.

At the time of the corporate reorganization of Business Loan Express, Inc. from a C corporation to a limited liability company in 2003, for tax purposes Ciena had a built-in gain representing the aggregate fair market value of its assets in excess of the tax basis of its assets. As a RIC, the Company will be subject to special built-in gain rules on the assets of Ciena. Under these rules, taxes will be payable by the Company at the time and to the extent that the built-in gains on Ciena s assets at the date of reorganization are recognized in a taxable disposition of such assets in the 10-year period following the date of the reorganization. At such time, the built-in gains, if any, realized upon the disposition of these assets will be included in the Company s taxable income, net of the corporate level taxes paid by the Company on the built-in gains. At the date of Ciena s reorganization, the Company estimated that its future tax liability resulting from the built-in gains may total up to a maximum of $40 million. However, if these assets are disposed of after the 10-year period, there will be no corporate level taxes on these built-in gains. The Company has no obligation to pay the built-in gains tax until these assets or its interests in Ciena are disposed of in the future, within the 10-year period, at a value that would result in a tax liability. At December 31, 2006, the Company considered the impact on the fair value of its investment in Ciena due to Ciena s tax attributes as an LLC and has also considered the impact on the fair value of its investment due to estimated built-in gain taxes, if any, in determining the fair value of its investment in Ciena. At December 31, 2007, there would be no built-in gain tax liability if the assets or the Company s interests in Ciena were sold at the current valuation.

Mercury Air Centers, Inc. In April 2004, the Company completed the purchase of a majority ownership in Mercury Air Centers, Inc. (Mercury). At December 31, 2006, the Company s investment in Mercury totaled $84.3 million at cost and $244.2 million at value, which included unrealized appreciation of $159.9 million.

In August 2007, the Company completed the sale of its majority equity interest in Mercury. For the year ended December 31, 2007, the Company realized a gain of $262.4 million, subject to post-closing adjustments. In addition, the Company was repaid approximately $51 million of subordinated debt outstanding to Mercury at closing.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3. Portfolio, continued

Mercury owned and operated fixed base operations generally under long-term leases from local airport authorities, which consisted of terminal and hangar complexes that serviced the needs of the general aviation community. Mercury was headquartered in Richmond Heights, OH.

Total interest and related portfolio income earned from the Company s investment in Mercury for the years ended December 31, 2007, 2006, and 2005, was as follows:

($ in millions)	2007	2006	2005
Interest income	$ 5.1	$ 9.3	$ 8.8
Fees and other income	0.2	0.6	0.7
Total interest and related portfolio income	$ 5.3	$ 9.9	$ 9.5

Net change in unrealized appreciation or depreciation for the year ended December 31, 2007, included an increase in unrealized appreciation totaling $74.9 million for the first half of 2007 and the reversal of $234.8 million associated with the sale of the Company s majority equity interest in the third quarter of 2007. Net change in unrealized appreciation or depreciation for the years ended December 31, 2006 and 2005, included an increase in unrealized appreciation of $106.1 million and $53.8 million, respectively, related to the Company s investment in Mercury.

Advantage Sales and Marketing, Inc. In June 2004, the Company completed the purchase of a majority voting ownership in Advantage. Advantage is a sales and marketing agency providing outsourced sales, merchandising, and marketing services to the consumer packaged goods industry. Advantage has offices across the United States and is headquartered in Irvine, CA.

On March 29, 2006, the Company sold its majority equity interest in Advantage. The Company was repaid its $184 million in subordinated debt outstanding at closing. For the year ended December 31, 2006, the Company realized a gain on the sale of its equity investment of $434.4 million, subject to post-closing adjustments and excluding any earn-out amounts. The Company realized additional gains in 2007 resulting from post-closing adjustments and an earn-out payment totaling $3.4 million, subject to additional post-closing adjustments.

As consideration for the common stock sold in the transaction, the Company received a $150 million subordinated note, with the balance of the consideration paid in cash. In addition, a portion of the Company s cash proceeds from the sale of the common stock were placed in escrow, subject to certain holdback provisions. At December 31, 2007, the amount of the escrow included in other assets in the accompanying consolidated balance sheet was approximately $25 million.

Total interest and related portfolio income earned from the Company s investment in Advantage while the Company held a majority equity interest for the years ended December 31, 2006 and 2005, was $14.1 million and $37.4 million, respectively. Net change in unrealized appreciation or depreciation for the year ended December 31, 2006, included the reversal of $389.7 million of previously recorded unrealized appreciation associated with the realization of a gain on the sale of the Company s majority equity interest in Advantage and for the year ended December 31, 2005, included an increase in unrealized appreciation of $378.4 million related to the Company s majority equity interest investment in Advantage.

In connection with the sale transaction, the Company retained an equity investment in the business valued at $15 million at closing as a minority shareholder. During the fourth quarter of 2006, Advantage

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3. Portfolio, continued

made a distribution on this minority equity investment, which reduced the Company s cost basis to zero and resulted in a realized gain of $4.8 million.

The Company s investment in Advantage at December 31, 2007, which was composed of subordinated debt and a minority equity interest, totaled $154.8 million at cost and $165.8 million at value. This investment was included in companies 5% to 25% owned in the consolidated financial statements as the Company continues to hold a seat on Advantage s board of directors.

Collateralized Loan Obligations (CLOs) and Collateralized Debt Obligations (CDOs). At December 31, 2007 and 2006, the Company owned bonds and preferred shares/income notes in CLOs and bonds in a CDO as follows:

	2007			2006		
($ in millions)	Cost	Value	Yield[1]	Cost	Value	Yield[1]
Bonds[2]:						
Callidus Debt Partners CDO Fund I, Ltd.	$ 28.4	$ 28.5	14.0%	$ 28.4	$ 28.4	14.0%
Callidus Debt Partners CLO Fund VI, Ltd.	4.3	4.3	13.4%			
Callidus MAPS CLO Fund I LLC	17.0	16.1	11.0%	17.0	17.2	10.8%
Dryden XVIII Leveraged Loan 2007 Limited	7.4	7.4	12.7%			
Knightsbridge CLO 2007-1 Limited	22.0	22.0	14.1%			
Pangaea CLO 2007-1 Ltd.	11.6	11.6	13.9%			
Total bonds	90.7	89.9	13.3%	45.4	45.6	12.8%
Preferred Shares/ Income Notes[3]:						
Callidus Debt Partners CLO Fund III, Ltd.	21.8	20.0	14.1%	23.3	23.0	12.8%
Callidus Debt Partners CLO Fund IV, Ltd.	12.3	11.3	16.1%	13.0	13.0	13.8%
Callidus Debt Partners CLO Fund V, Ltd.	14.0	14.7	19.3%	13.8	13.8	15.8%
Callidus Debt Partners CLO Fund VI, Ltd.	27.0	27.0	19.3%			
Callidus Debt Partners CLO Fund VII, Ltd.	22.1	22.1	16.6%			
Callidus MAPS CLO Fund I LLC	49.3	36.1	7.6%	51.0	47.4	17.1%
Callidus MAPS CLO Fund II, Ltd.	18.7	18.7	14.7%			
Dryden XVIII Leveraged Loan 2007 Limited	21.9	21.9	14.2%			
Knightsbridge CLO 2007-1 Limited	31.2	31.2	15.2%			
Total preferred shares/income notes	218.3	203.0	14.6%	101.1	97.2	15.5%
Total	$ 309.0	$ 292.9		$ 146.5	$ 142.8	

[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 market yield used in the valuation of the CLO and CDO assets may be different than the

interest yields shown above. The yield on these debt and equity securities is included in interest income in the accompanying consolidated statement of operations.

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

(3) These securities are included in private finance equity securities.

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.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3. Portfolio, continued

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 distributed to the preferred shareholders and income note holders. To the extent there are defaults and unrecoverable losses on the underlying collateral assets that result in reduced cash flows, the preferred shares/income notes will bear this loss first and then the subordinated bonds would bear any loss after the preferred shares/income notes. At December 31, 2007 and 2006, the face value of the CLO and CDO assets held by the Company was subordinate to as much as 94% and 92%, respectively, of the face value of the securities outstanding in these CLOs and CDO.

At December 31, 2007 and 2006, the underlying collateral assets of these CLO and CDO issuances, consisting primarily of senior corporate loans, were issued by 671 issuers and 465 issuers, respectively, and had balances as follows:

($ in millions)	2007	2006
Bonds	$ 288.5	$ 245.4
Syndicated loans	4,122.7	1,769.9
Cash[1]	104.4	59.5
Total underlying collateral assets[2]	$ 4,515.6	$ 2,074.8

[1] Includes undrawn liability amounts.

[2] At December 31, 2007 and 2006, the total face value of defaulted obligations was $18.4 million and $9.6 million, respectively, or approximately 0.4% and 0.5% respectively, of the total underlying collateral assets.

Loans and Debt Securities on Non-Accrual Status. At December 31, 2007 and 2006, private finance loans and debt securities at value not accruing interest were as follows:

($ in millions)	2007	2006
Loans and debt securities in workout status		
Companies more than 25% owned	$ 114.1	$ 51.1
Companies 5% to 25% owned	11.7	4.0
Companies less than 5% owned	23.8	31.6
Loans and debt securities not in workout status		
Companies more than 25% owned	21.4	87.1
Companies 5% to 25% owned	13.4	7.2
Companies less than 5% owned	13.3	38.9
Total	$ 197.7	$ 219.9

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3. Portfolio, continued

Industry and Geographic Compositions. The industry and geographic compositions of the private finance portfolio at value at December 31, 2007 and 2006, were as follows:

	2007	2006
Industry		
Business services	37%	39%
Consumer products	25	20
Industrial products	10	9
Financial services	7	9
CLO/CDO[1]	6	3
Retail	4	6
Consumer services	4	6
Healthcare services	3	3
Other	4	5
Total	100%	100%
Geographic Region[2]		
Mid-Atlantic	36%	31%
Midwest	32	30
Southeast	17	18
West	14	17
Northeast	1	4
Total	100%	100%

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

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

Commercial Real Estate Finance

At December 31, 2007 and 2006, the commercial real estate finance portfolio consisted of the following:

	2007			2006		
($ in millions)	**Cost**	**Value**	**Yield[1]**	**Cost**	**Value**	**Yield[1]**
Commercial mortgage loans	$ 65.9	$ 65.4	6.8%	$ 72.6	$ 71.9	7.5%
Real estate owned	15.3	21.3		15.7	19.6	
Equity interests	15.7	34.5		15.2	26.7	

Total	$ 96.9	$ 121.2	$ 103.5	$ 118.2

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

Commercial Mortgage Loans and Equity Interests. The commercial mortgage loan portfolio contains loans that were originated by the Company or were purchased from third-party sellers. At December 31, 2007,

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3. Portfolio, continued

approximately 85% and 15% of the Company s commercial mortgage loan portfolio was composed of fixed and adjustable interest rate loans, respectively. At December 31, 2006, approximately 96% and 4% of the Company s commercial mortgage loan portfolio was composed of fixed and adjustable interest rate loans, respectively. At December 31, 2007 and 2006, loans with a value of $14.3 million and $18.9 million, respectively, were not accruing interest. Loans greater than 120 days delinquent generally do not accrue interest.

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

The property types and the geographic composition securing the commercial mortgage loans and equity interests at value at December 31, 2007 and 2006, were as follows:

	2007	2006
Property Type		
Hospitality	44%	45%
Office	21	20
Retail	18	19
Recreation	15	1
Housing		13
Other	2	2
Total	100%	100%
Geographic Region		
Southeast	37%	36%
Midwest	31	21
West	20	21
Northeast	8	8
Mid-Atlantic	4	14
Total	100%	100%

CMBS Bonds and Collateralized Debt Obligation Bonds and Preferred Shares (CDOs). On May 3, 2005, the Company completed the sale of its portfolio of CMBS bonds and CDO bonds and preferred shares to affiliates of Caisse de dépôt et placement du Québec (the Caisse) for cash proceeds of $976.0 million and realized a net gain of $227.7 million, after transaction and other costs of $7.8 million. Transaction costs included investment banking fees, legal and other professional fees, and other transaction costs. Upon the closing of the sale, the Company settled all the hedge positions relating to these assets, which resulted in a net realized loss of $0.7 million, which has been included in the net realized gain on the sale. The value of these assets prior to their sale was determined on an individual security-by-security basis. The net gain realized upon the sale of $227.7 million reflects the total value received for the portfolio as a whole. Simultaneous with the sale of the Company s CMBS and CDO portfolio, the Company entered into certain agreements with affiliates of the Caisse, including a platform assets purchase agreement, pursuant to which the Company agreed to sell certain additional commercial real estate-related assets to the Caisse, subject to certain adjustments and closing conditions.

The platform assets purchase agreement was completed on July 13, 2005, and the Company received total cash proceeds from the sale of the platform assets of approximately $5.3 million. No gain or loss

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3. Portfolio, continued

resulted from the transaction. Under this agreement, the Company agreed not to primarily invest in non-investment grade CMBS and real estate-related CDOs and refrain from certain other real estate-related investing or servicing activities for a period of three years or through May 2008 subject to certain limitations and excluding the Company s existing portfolio and related activities.

Managed Funds

The Company manages funds that invest in the debt and equity of primarily private middle market companies in a variety of industries. As of December 31, 2007, the funds that the Company manages had total assets of approximately $400 million. During 2007, the Company launched the Allied Capital Senior Debt Fund, L.P. and the Unitranche Fund LLC, and in early 2008, the Company formed the AGILE Fund I, LLC, all discussed below (together, the Managed Funds). The Company s responsibilities to the Managed Funds may include deal origination, underwriting, and portfolio monitoring and development services consistent with the activities that the Company performs for its portfolio. Each of the Managed Funds may separately invest in the debt or equity of a portfolio company. The Company s portfolio may include debt or equity investments issued by the same portfolio company as investments held by one or more Managed Funds, and these investments may be senior, pari passu or junior to the debt and equity investments held by the Company.

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

Allied Capital Senior Debt Fund, L.P. The Company is a special limited partner in the Allied Capital Senior Debt Fund, L.P. (ACSDF), a private fund that generally invests in senior, unitranche and second lien debt. The Company has committed and funded $31.8 million to ACSDF, which is a portfolio company. At December 31, 2007, the Company s investment in ACSDF totaled $31.8 million at cost and $32.8 million at value. ACSDF has closed on $125 million in equity capital commitments and had total assets of approximately $400 million. As a special limited partner, the Company expects to earn an incentive allocation of 20% of the annual net income of ACSDF, subject to certain performance benchmarks. The value of the Company s investment in ACSDF is based on the net asset value of ACSDF, which reflects the capital invested plus its allocation of the net earnings of ACSDF, including the incentive allocation.

AC Corp is the investment manager to ACSDF. Callidus Capital Corporation, a portfolio investment controlled by the Company, acts as special manager to ACSDF. An affiliate of the Company is the general partner of ACSDF, and AC Corp serves as collateral manager to a warehouse financing vehicle associated with ACSDF. AC Corp will earn a management fee of up to 2% per annum of the net asset value of ACSDF and will pay Callidus 25% of that management fee to compensate Callidus for its role as special manager.

In connection with ACSDF s formation in June 2007, the Company sold an initial portfolio of approximately $183 million of seasoned assets with a weighted average yield of 10.3% to a warehouse financing vehicle associated with ACSDF. In the second half of 2007, the Company sold $41.7 million of seasoned assets with a weighted average yield of 8.5% to the warehouse financing vehicle. The Company

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3. Portfolio, continued

may offer to sell additional loans to ACSDF or the warehouse financing vehicle. ACSDF or the warehouse financing vehicle may purchase loans from the Company. ACSDF also purchases loans from other third parties. In addition, during the second half of 2007, the Company repurchased one asset totaling $12.0 million from ACSDF, which the Company had sold to ACSDF in June 2007.

Unitranche Fund LLC. In December 2007, the Company formed the Unitranche Fund LLC (Unitranche Fund), which the Company co-manages with an affiliate of General Electric Capital Corporation (GE). The Unitranche Fund is a private fund that generally focuses on making first lien unitranche loans to middle market companies with Earning before Interest, Taxes, Depreciation, and Amortization of at least $15 million. GE has committed $3.075 billion to the Unitranche Fund consisting of $3.0 billion of senior notes and $0.075 billion of subordinated certificates and the Company has committed $525.0 million of subordinated certificates. The Unitranche Fund will be capitalized as transactions are completed. At December 31, 2007, the Company s investment in the Unitranche Fund totaled $0.7 million at cost and at value. The Company will earn a management and sourcing fee totaling 0.375% per annum of managed assets.

AGILE Fund I, LLC. In January 2008, the Company entered into an investment agreement with the Goldman Sachs Private Equity Group, part of Goldman Sachs Asset Management (Goldman Sachs). As part of the investment agreement, the Company agreed to sell a pro-rata strip of private equity and debt investments to AGILE Fund I, LLC (AGILE), a private fund in which a fund managed by Goldman Sachs owns substantially all of the interests, for a total transaction value of $169 million. The majority of the investment sale closed simultaneously with the execution of the investment agreement. The sales of the remaining assets are expected to close by the end of the first quarter of 2008, subject to certain terms and conditions.

The sale to AGILE included 13.7% of the Company s equity investments in 23 of its buyout portfolio companies and 36 of its minority equity portfolio companies for a total purchase price of $109 million. In addition, the Company sold approximately $60 million in debt investments, which represented 7.3% of its unitranche, second lien and subordinated debt investments in the buyout investments included in the equity sale. AGILE generally has the right to co-invest in its proportional share of any future follow-on investment opportunities presented by the companies in its portfolio.

The Company is the managing member of AGILE, and will be entitled to an incentive allocation subject to certain performance benchmarks. The Company owns the remaining interests in AGILE not held by Goldman Sachs.

In addition, pursuant to the investment agreement Goldman Sachs has committed to invest at least $125 million in future investment vehicles managed by the Company and will have future opportunities to invest in the Company s affiliates, or vehicles managed by them, and to coinvest alongside the Company in the future, subject to various terms and conditions. As part of this transaction, the Company has also agreed to sell 11 venture capital and private equity limited partnership investments for approximately $28 million to a fund managed by Goldman Sachs, which will assume the $6.5 million of unfunded commitments related to these limited partnership investments. The sales of these limited partnership investments are expected to be completed by May 2008.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 4. Debt

At December 31, 2007 and 2006, the Company had the following debt:

	2007			2006		
($ in millions)	**Facility Amount**	**Amount Drawn**	**Annual Interest Cost[(1)]**	**Facility Amount**	**Amount Drawn**	**Annual Interest Cost[(1)]**
Notes payable and debentures:						
Privately issued unsecured notes payable	$ 1,042.2	$ 1,042.2	6.1%	$ 1,041.4	$ 1,041.4	6.1%
Publicly issued unsecured notes payable	880.0	880.0	6.7%	650.0	650.0	6.6%
Total notes payable and debentures	1,922.2	1,922.2	6.4%	1,691.4	1,691.4	6.3%
Revolving line of credit[(4)]	922.5	367.3	5.9%[(2)]	922.5	207.7	6.4%[(2)]
Total debt	$ 2,844.7	$ 2,289.5	6.5%[(3)]	$ 2,613.9	$ 1,899.1	6.5%[(3)]

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

(2) The annual interest cost reflects the interest rate payable for borrowings under the revolving line of credit. In addition to the current interest payable, there were annual costs of commitment fees, other facility fees and amortization of debt financing costs of $3.7 million and $3.9 million at December 31, 2007 and 2006, respectively.

(3) The annual interest cost for total debt includes the annual cost of commitment fees, other facility fees and amortization of debt financing costs on the revolving line of credit regardless of the amount outstanding on the facility as of the balance sheet date.

(4) At December 31, 2007, $496.7 million remained unused and available on the revolving line of credit, net of amounts committed for standby letters of credit of $58.5 million issued under the credit facility.

Notes Payable and Debentures

Privately Issued Unsecured Notes Payable. The Company has privately issued unsecured long-term notes to institutional investors. The notes have five- or seven-year maturities and have fixed rates of interest. The notes generally require payment of interest only semi-annually, and all principal is due upon maturity. At December 31, 2007, the notes had maturities from May 2008 to May 2013. The notes may be prepaid in whole or in part, together with an interest premium, as stipulated in the note agreements.

The Company has issued five-year unsecured long-term notes denominated in Euros and Sterling for a total U.S. dollar equivalent of $15.2 million. The notes have fixed interest rates and have substantially the same terms as the

Company s other unsecured notes. The Euro notes require annual interest payments and the Sterling notes require semi-annual interest payments until maturity. Simultaneous with issuing the notes, the Company entered into a cross currency swap with a financial institution which fixed the Company s interest and principal payments in U.S. dollars for the life of the debt.

On October 16, 2006, the Company repaid $150.0 million of unsecured long-term debt that matured. This debt had a fixed interest rate of 7.2%.

On May 1, 2006, the Company issued $50.0 million of seven-year, unsecured notes with a fixed interest rate of 6.8%. This debt matures in May 2013. The proceeds from the issuance of the notes were used in part to repay $25 million of 7.5% unsecured long-term notes that matured on May 1, 2006.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 4. Debt, continued

Publicly Issued Unsecured Notes Payable. At December 31, 2007, the Company had outstanding publicly issued unsecured notes as follows:

($ in millions)		Amount	Maturity Date
6.625% Notes due 2011	$	400.0	July 15, 2011
6.000% Notes due 2012		250.0	April 1, 2012
6.875% Notes due 2047		230.0	April 15, 2047
Total	$	880.0	

The 6.625% Notes due 2011 and the 6.000% Notes due 2012 require payment of interest only semi-annually, and all principal is due upon maturity. The Company has the option to redeem these notes in whole or in part, together with a redemption premium, as stipulated in the notes.

On March 28, 2007, the Company completed the issuance of $200.0 million of 6.875% Notes due 2047 for net proceeds of $193.0 million. In April 2007, the Company issued additional notes, through an over-allotment option, totaling $30.0 million for net proceeds of $29.1 million. Net proceeds are net of underwriting discounts and estimated offering expenses.

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

Scheduled Maturities. Scheduled future maturities of notes payable at December 31, 2007, were as follows:

Year		Amount Maturing ($ in millions)
2008	$	153.0
2009		269.7
2010		408.0
2011		472.5
2012		339.0
Thereafter		280.0
Total	$	1,922.2

Revolving Line of Credit

At December 31, 2007 and 2006, the Company had an unsecured revolving line of credit with a committed amount of $922.5 million that expires on September 30, 2008. At the Company s option, borrowings under the revolving line of credit generally bear interest at a rate equal to (i) LIBOR (for the period the Company selects) plus 1.05% or (ii) the higher of the Federal Funds rate plus 0.50% or the Bank of America, N.A. prime rate. The revolving line of credit requires the payment of an annual commitment fee equal to 0.20% of the committed amount (whether used or unused). The revolving line of credit generally requires payments of interest at the end of each LIBOR interest period, but no less frequently than quarterly, on LIBOR based loans and monthly payments of interest on other loans.

All principal is due upon maturity.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 4. Debt, continued

The annual cost of commitment fees, other facility fees and amortization of debt financing costs was $3.7 million and $3.9 million at December 31, 2007 and 2006, respectively.

The revolving credit facility provides for a sub-facility for the issuance of letters of credit for up to an amount equal to 16.66% of the committed facility or $153.7 million. The letter of credit fee is 1.05% per annum on letters of credit issued, which is payable quarterly.

The average debt outstanding on the revolving line of credit was $58.5 million and $142.1 million, respectively, for the years ended December 31, 2007 and 2006. The maximum amount borrowed under this facility and the weighted average stated interest rate for the years ended December 31, 2007 and 2006, were $381.3 million and 6.3%, respectively, and $540.3 million and 6.3%, respectively. At December 31, 2007, the amount available under the revolving line of credit was $496.7 million, net of amounts committed for standby letters of credit of $58.5 million issued under the credit facility.

Fair Value of Debt

The Company records debt at cost. The fair value of the Company s outstanding debt was approximately $2.2 billion and $1.9 billion at December 31, 2007 and 2006, respectively. The fair value of the Company s publicly issued 6.875% Notes due 2047 was determined using the market price of the retail notes at December 31, 2007. The fair value of the Company s other debt was determined using market interest rates as of the balance sheet date for similar instruments.

Covenant Compliance

The Company has various financial and operating covenants required by the revolving line of credit and the privately issued unsecured notes payable outstanding at December 31, 2007 and 2006. These covenants require the Company to maintain certain financial ratios, including asset coverage, debt to equity and interest coverage, and a minimum net worth. These credit facilities provide for customary events of default, including, but not limited to, payment defaults, breach of representations or covenants, cross-defaults, bankruptcy events, failure to pay judgments, attachment of the Company s assets, change of control and the issuance of an order of dissolution. Certain of these events of default are subject to notice and cure periods or materiality thresholds. The Company s credit facilities limit its ability to declare dividends if the Company defaults under certain provisions. As of December 31, 2007 and 2006, the Company was in compliance with these covenants.

The Company has certain financial and operating covenants that are required by the publicly issued unsecured notes payable, including that the Company will maintain a minimum ratio of 200% of total assets to total borrowings, as required by the Investment Company Act of 1940, as amended, while these notes are outstanding. As of December 31, 2007 and 2006, the Company was in compliance with these covenants.

Note 5. Guarantees and Commitments

In the ordinary course of business, the Company has issued guarantees and has extended standby letters of credit through financial intermediaries on behalf of certain portfolio companies. All standby letters of credit have been issued through Bank of America, N.A. As of December 31, 2007 and 2006, the Company had issued guarantees of debt and rental obligations aggregating $270.6 million and $202.1 million, respectively, and had extended standby letters of credit aggregating $58.5 million and

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 5. Guarantees and Commitments, continued

$41.0 million, respectively. Under these arrangements, the Company would be required to make payments to third-party beneficiaries if the portfolio companies were to default on their related payment obligations. The maximum amount of potential future payments was $329.1 million and $243.1 million at December 31, 2007 and 2006, respectively.

As of December 31, 2007, the guarantees and standby letters of credit expired as follows:

(in millions)	Total	2008	2009	2010	2011	2012	After 2012
Guarantees	$ 270.6	$ 3.0	$ 261.2	$	$ 4.4	$ 0.1	$ 1.9
Standby letters of credit[1]	58.5	58.5					
Total[2]	$ 329.1	$ 61.5	$ 261.2	$	$ 4.4	$ 0.1	$ 1.9

[1] Standby letters of credit are issued under the Company s revolving line of credit that expires in September 2008. Therefore, unless a standby letter of credit is set to expire at an earlier date, it is assumed that the standby letters of credit will expire contemporaneously with the expiration of the Company s line of credit in September 2008.

[2] The Company s most significant commitments relate to its investment in Ciena Capital LLC (Ciena), which commitments totaled $276.7 million at December 31, 2007. At December 31, 2007, the Company guaranteed 60% of the outstanding total obligations on Ciena s revolving line of credit, which matures in March 2009, for a total guaranteed amount of $258.7 million and had standby letters of credit issued totaling $18.0 million in connection with term securitizations completed by Ciena. In January 2008, the Company increased the guaranteed amount on Ciena s revolving line of credit from 60% to 100% in connection with an amendment completed by Ciena and also issued additional letters of credit totaling $42.5 million related to other term securitizations completed by Ciena. See Note 3.

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

At December 31, 2007, the Company had outstanding commitments to fund investments totaling $923.6 million, including $882.4 million related to private finance investments and $41.2 million related to commercial real estate finance investments. Total outstanding commitments related to private finance investments included $524.3 million to the Unitranche Fund LLC, which the Company estimates will be funded over a two to three year period as investments are funded by the Unitranche Fund. See Note 3.

Note 6. Shareholders Equity

Sales of common stock for the years ended December 31, 2007, 2006, and 2005, were as follows:

(in millions)	2007	2006	2005[1]
Number of common shares	6.6	10.9	
Gross proceeds	$ 177.7	$ 310.2	$
Less costs, including underwriting fees	(6.4)	(14.4)	

Net proceeds	$ 171.3	$ 295.8	$

(1) The Company did not sell any common stock during the year ended December 31, 2005.

The Company issued 0.6 million shares, 0.5 million shares, and 3.0 million shares of common stock upon the exercise of stock options during the years ended December 31, 2007, 2006, and 2005,

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 6. Shareholders Equity, continued

respectively. In addition, in July 2007, the Company issued 1.7 million unregistered shares of common stock upon the cancellation of stock options pursuant to a tender offer. See Note 9.

The Company issued 0.3 million shares of common stock with a value of $7.2 million as consideration for an additional investment in Mercury Air Centers, Inc. during the year ended December 31, 2005.

The Company has a dividend reinvestment plan, whereby the Company may buy shares of its common stock in the open market or issue new shares in order to satisfy dividend reinvestment requests. If the Company issues new shares, the issue price is equal to the average of the closing sale prices reported for the Company s common stock for the five consecutive trading days immediately prior to the dividend payment date. For the years ended December 31, 2007, 2006, and 2005, the Company issued new shares in order to satisfy dividend reinvestment requests. Dividend reinvestment plan activity for the years ended December 31, 2007, 2006, and 2005, was as follows:

(in millions, except per share amounts)	**2007**	**2006**	**2005**
Shares issued	0.6	0.5	0.3
Average price per share	$ 27.40	$ 30.58	$ 28.00

Note 7. Earnings Per Common Share

Earnings per common share for the years ended December 31, 2007, 2006, and 2005, were as follows:

(in millions, except per share amounts)	**2007**	**2006**	**2005**
Net increase in net assets resulting from operations	$ 153.3	$ 245.1	$ 872.8
Weighted average common shares outstanding basic	152.9	142.4	134.7
Dilutive options outstanding	1.8	3.2	2.6
Weighted average common shares outstanding diluted	154.7	145.6	137.3
Basic earnings per common share	$ 1.00	$ 1.72	$ 6.48
Diluted earnings per common share	$ 0.99	$ 1.68	$ 6.36

Note 8. Employee Compensation Plans

401(k) Plan. Prior to the 2008 Plan Year, the Company s 401(k) retirement investment plan was open to all of its full-time employees who were at least 21 years of age. The employees could elect voluntary pre-tax wage deferrals ranging from 0% to 100% of eligible compensation for the year up to $15.5 thousand annually for the 2007 plan year. Plan participants who were age 50 or older during the 2007 plan year were eligible to defer an additional $5 thousand during the year. For the years ended December 31, 2007, 2006, and 2005, the Company made contributions to the 401(k) plan of up to 5% of each participant s eligible compensation for the year up to a maximum compensation permitted by the IRS, which fully vests at the time of contribution. For the year ended December 31, 2007, the maximum compensation was $0.2 million. Employer contributions that exceed the IRS limitation (excess contributions) were directed to the participant s deferred compensation plan account as discussed below for the 2006 and 2005 plan years. Excess contributions for the 2007 plan year totaled $2.0 million and will be

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 8. Employee Compensation Plans, continued

paid to participants in cash as a result of the planned termination of the deferred compensation arrangements in the first quarter of 2008 as discussed below. Total 401(k) contribution expense for the years ended December 31, 2007, 2006, and 2005, was $1.4 million, $1.2 million, and $1.0 million, respectively.

For the 2008 plan year, the Company amended its 401(k) plan to amend certain plan features, and to provide that the Company will match 100% of the first 4% of deferral contributions made by each participant on up to $0.2 million of eligible compensation. There will be no excess contributions.

Deferred Compensation Plans. The Company also has deferred compensation plans. The Company s deferred compensation arrangements will be terminated effective March 18, 2008, as discussed below, and no further contributions were accepted into the plans after December 31, 2007.

Through December 31, 2007, eligible participants in the deferred compensation plan (DCP I) could elect to defer some of their compensation and have such compensation credited to a participant account. In addition, the Company made contributions to the deferred compensation plan on compensation deemed ineligible for a 401(k) contribution for 2006 and 2005. Contribution expense for the deferred compensation plan for the years ended December 31, 2006 and 2005, was $1.5 million and $0.7 million, respectively. All amounts credited to a participant s account were credited solely for purposes of accounting and computation and remain assets of the Company and subject to the claims of the Company s general creditors until distributed. Amounts credited to participants under the deferred compensation plan are at all times 100% vested and non-forfeitable. Amounts deferred by participants under the deferred compensation plan were funded to a trust, which is administered by a third-party trustee. The accounts of the deferred compensation trust are consolidated with the Company s accounts. The assets of the trust are classified as other assets and the liability to the plan participants is included in other liabilities in the accompanying financial statements. The deferred compensation plan accounts at December 31, 2007 and 2006, totaled $21.1 million and $18.6 million, respectively.

The Company has an Individual Performance Award (IPA), which was established as a long-term incentive compensation program for certain officers. In conjunction with the program, the Board of Directors approved non-qualified deferred compensation plans (DCP II), which are administered through a trust by a third-party trustee. The administrator of the DCP II is the Compensation Committee of the Company s Board of Directors.

The IPA is generally determined annually at the beginning of each year but may be adjusted throughout the year. Through December 31, 2007, the IPA was deposited in the trust in four equal installments, generally on a quarterly basis, in the form of cash. The Compensation Committee of the Board of Directors designed the DCP II to require the trustee to use the cash to purchase shares of the Company s common stock in the open market. During the years ended December 31, 2007, 2006, and 2005, 0.4 million shares, 0.3 million shares, and 0.3 million shares, respectively, were purchased in the DCP II.

All amounts deposited and then credited to a participant s account in the trust, based on the amount of the IPA received by such participant, were credited solely for purposes of accounting and computation and remain assets of the Company and subject to the claims of the Company s general creditors until distributed. Amounts credited to participants under the DCP II are immediately vested and generally non-forfeitable once deposited by the Company into the trust.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 8. Employee Compensation Plans, continued

During any period of time in which a participant has an account in the DCP II, any dividends declared and paid on shares of the Company s common stock allocated to the participant s account were reinvested in shares of the Company s common stock.

Through December 31, 2007, the IPA amounts were contributed into the DCP II trust and invested in the Company s common stock. The accounts of the DCP II are consolidated with the Company s accounts. The common stock is classified as common stock held in deferred compensation trust in the accompanying financial statements and the deferred compensation obligation, which represents the amount owed to the employees, is included in other liabilities. Changes in the value of the Company s common stock held in the deferred compensation trust are not recognized. However, the liability is marked to market with a corresponding charge or credit to employee compensation expense. At December 31, 2007 and 2006, common stock held in DCP II was $39.9 million and $28.3 million, respectively, and the IPA liability was $31.4 million and $33.9 million, respectively. At December 31, 2007 and 2006, the DCP II held 1.4 million shares and 1.0 million shares, respectively, of the Company s common stock.

The IPA expense for the years ended December 31, 2007, 2006, and 2005, was as follows:

($ in millions)	2007	2006	2005
IPA contributions	$ 9.8	$ 8.1	$ 7.0
IPA mark to market expense (benefit)	(14.0)	2.9	2.0
Total IPA expense (benefit)	$ (4.2)	$ 11.0	$ 9.0

The Company also has an individual performance bonus (IPB) which is distributed in cash to award recipients throughout the year (beginning in February of each year) as long as the recipient remains employed by the Company. If a recipient terminates employment during the year, any remaining cash payments under the IPB would be forfeited. For the years ended December 31, 2007, 2006, and 2005, the IPB expense was $9.5 million, $8.1 million, and $6.9 million, respectively. The IPA and IPB expenses are included in employee expenses.

Termination of Deferred Compensation Plans. On December 14, 2007, the Company s Board of Directors made a determination that it is in the Company s best interest to terminate its deferred compensation plans. The Board of Directors decision was primarily in response to increased complexity resulting from recent changes in the regulation of deferred compensation arrangements. The accounts under these plans will be distributed to participants in full on March 18, 2008, the termination and distribution date, or as soon as is reasonably practicable thereafter, in accordance with the transition rule for payment elections under Section 409A of the Code. Distributions from the plans will be made in cash or shares of the Company s common stock, net of required withholding taxes.

For 2008, the Compensation Committee has determined that the IPA will be paid in cash in two equal installments during the year to eligible officers, as long as the recipient remains employed by the Company.

Note 9. Stock Option Plan

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 9. Stock Option Plan, continued

the option is granted. The options granted to officers generally vest ratably over up to a three year period. Options granted to non-officer directors vest on the grant date.

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

At December 31, 2006, there were 32.2 million shares authorized under the Option Plan. On May 15, 2007, the Company s stockholders voted to increase the number of shares of common stock authorized for issuance to 37.2 million shares. At December 31, 2007, there were 37.2 million shares authorized under the Option Plan.

On July 18, 2007, the Company completed a tender offer related to the Company s offer to all optionees who held vested in-the-money stock options as of June 20, 2007, the opportunity to receive an option cancellation payment (OCP) equal to the in-the-money value of the stock options cancelled, determined using the Weighted Average Market Price of $31.75, which would be paid one-half in cash and one-half in unregistered shares of the Company s common stock. The Company accepted for cancellation 10.3 million vested options, which in the aggregate had a weighted average exercise price of $21.50. This resulted in a total option cancellation payment of approximately $105.6 million, of which $52.8 million was paid in cash and $52.8 million was paid through the issuance of 1.7 million unregistered shares of the Company s common stock, determined using the Weighted Average Market Price of $31.75. The Weighted Average Market Price represented the volume weighted average price of the Company s common stock over the fifteen trading days preceding the first day of the offer period, or June 20, 2007. See Note 2 Stock Compensation Plans.

At December 31, 2007 and 2006, the number of shares available to be granted under the Option Plan was 10.7 million and 1.6 million, respectively.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 9. Stock Option Plan, continued

Information with respect to options granted, exercised and forfeited under the Option Plan for the years ended December 31, 2007, 2006, and 2005, was as follows:

(in millions, except per share amounts)	Shares	Weighted Average Exercise Price Per Share	Weighted Average Contractual Remaining Term (Years)	Aggregate Intrinsic Value at December 31, 2007[1]
Options outstanding at January 1, 2005	20.4	$ 23.55		
Granted	6.8	$ 27.37		
Exercised	(3.0)	$ 22.32		
Forfeited	(1.9)	$ 27.83		
Options outstanding at December 31, 2005	22.3	$ 24.52		
Granted	1.8	$ 29.88		
Exercised	(0.5)	$ 22.99		
Forfeited	(0.4)	$ 27.67		
Options outstanding at December 31, 2006	23.2	$ 24.92		
Granted	6.7	$ 29.52		
Exercised	(0.6)	$ 25.25		
Cancelled in tender offer[2]	(10.3)	$ 21.50		
Forfeited	(0.5)	$ 28.96		
Options outstanding at December 31, 2007	18.5	$ 28.36	6.58	$ 0.2
Exercisable at December 31, 2007[3]	11.7	$ 27.99	6.54	$ 0.2
Exercisable and expected to be exercisable at December 31, 2007[4]	17.9	$ 28.34	6.58	$ 0.2

(1) Represents the difference between the market value of the options at December 31, 2007, and the cost for the option holders to exercise the options.
(2) See description of the tender offer above.
(3) Represents vested options.
(4) The amount of options expected to be exercisable at December 31, 2007, is calculated based on an estimate of expected forfeitures.

The fair value of the shares vested during the years ended December 31, 2007, 2006, and 2005, was $21.6 million, $16.1 million, and $16.2 million, respectively. The total intrinsic value of the options exercised during the years ended December 31, 2007, 2006, and 2005, was $2.7 million, $3.6 million, and $18.4 million, respectively.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 9. Stock Option Plan, continued

The following table summarizes information about stock options outstanding at December 31, 2007:

		Outstanding			Exercisable	
Range of Exercise Prices		Total Number Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Total Number Exercisable	Weighted Average Exercise Price
(in millions, except per share amounts and years)						
$16.81	$26.80	1.9	6.02	$ 24.05	1.8	$ 24.02
$27.00	$27.38	0.1	6.56	$ 27.13	0.1	$ 27.10
$27.51		4.8	7.59	$ 27.51	3.1	$ 27.51
$28.15	$29.23	4.2	6.34	$ 28.94	3.9	$ 28.97
$29.58		6.3	6.36	$ 29.58	2.1	$ 29.58
$30.00	$30.52	1.2	5.43	$ 30.13	0.7	$ 30.08
		18.5	6.58	$ 28.36	11.7	$ 27.99

On February 1, 2008, the Company granted 7.1 million options with an exercise price of $22.96. The options vest ratably over a three-year term beginning on June 30, 2009.

Notes Receivable from the Sale of Common Stock

As a business development company under the 1940 Act, the Company is entitled to provide and has provided loans to the Company s officers in connection with the exercise of options. However, as a result of provisions of the Sarbanes-Oxley Act of 2002, the Company is prohibited from making new loans to its executive officers. The outstanding loans are full recourse, have varying terms not exceeding ten years, bear interest at the applicable federal interest rate in effect at the date of issue and have been recorded as a reduction to shareholders equity. At December 31, 2007 and 2006, the Company had outstanding loans to officers of $2.7 million and $2.9 million, respectively. Officers with outstanding loans repaid principal of $0.2 million, $1.0 million, and $1.6 million, for the years ended December 31, 2007, 2006, and 2005, respectively. The Company recognized interest income from these loans of $0.1 million, $0.2 million, and $0.2 million, respectively, during these same periods. This interest income is included in interest and dividends for companies less than 5% owned.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 10. Dividends and Distributions and Taxes

For the years ended December 31, 2007, 2006, and 2005, the Company s Board of Directors declared the following distributions:

	2007		2006		2005	
(in millions, except per share amounts)	**Total Amount**	**Total Per Share**	**Total Amount**	**Total Per Share**	**Total Amount**	**Total Per Share**
First quarter	$ 95.8	$ 0.63	$ 82.5	$ 0.59	$ 76.1	$ 0.57
Second quarter	97.6	0.64	84.1	0.60	76.2	0.57
Third quarter	100.3	0.65	88.8	0.61	78.8	0.58
Fourth quarter	102.6	0.65	92.0	0.62	79.3	0.58
Extra dividend	11.0	0.07	7.5	0.05	4.1	0.03
Total distributions to common shareholders	$ 407.3	$ 2.64	$ 354.9	$ 2.47	$ 314.5	$ 2.33

For income tax purposes, distributions for 2007, 2006, and 2005, were composed of the following:

	2007		2006		2005	
(in millions, except per share amounts)	**Total Amount**	**Total Per Share**	**Total Amount**	**Total Per Share**	**Total Amount**	**Total Per Share**
Ordinary income(1)(2)	$ 126.7	$ 0.82	$ 177.4	$ 1.23	$ 157.3	$ 1.17
Long-term capital gains	280.6	1.82	177.5	1.24	157.2	1.16
Total distributions to common shareholders	$ 407.3	$ 2.64	$ 354.9	$ 2.47	$ 314.5	$ 2.33

(1) For the years ended December 31, 2007, 2006, and 2005, ordinary income included dividend income of approximately zero, $0.04 per share, and $0.03 per share, respectively, that qualified to be taxed at the 15% maximum capital gains rate.

(2) For certain eligible corporate shareholders, the dividend received deduction for 2007, 2006, and 2005, was zero, $0.042 per share, and $0.034 per share, respectively.

The Company s Board of Directors also declared a dividend of $0.65 per common share for the first quarter of 2008.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 10. Dividends and Distributions and Taxes, continued

The following table summarizes the differences between financial statement net increase in net assets resulting from operations and taxable income available for distribution to shareholders for the years ended December 31, 2007, 2006, and 2005:

($ in millions)	2007 (ESTIMATED)[1]	2006	2005
Financial statement net increase in net assets resulting from operations	$ 153.3	$ 245.1	$ 872.8
Adjustments:			
Net change in unrealized appreciation or depreciation	256.2	477.4	(462.1)
Amortization of discounts and fees	0.7	(1.7)	4.7
Interest- and dividend-related items	6.0	11.9	5.5
Employee compensation-related items	0.2	23.1	3.0
Nondeductible excise tax	16.3	15.4	6.2
Realized gains recognized (deferred) through installment treatment[2]	(12.7)	(182.3)	(5.9)
Other realized gain or loss related items	(7.2)	15.0	18.6
Net income (loss) from partnerships and limited liability companies[3]	(6.6)	(4.7)	18.0
Net loss from consolidated SBIC subsidiary			(8.4)
Net (income) loss from consolidated taxable subsidiary, net of tax	1.4	3.9	(5.0)
Other		(1.9)	(2.4)
Taxable income	$ 407.6	$ 601.2	$ 445.0

(1) The Company s taxable income for 2007 is an estimate and will not be finally determined until the Company files its 2007 tax return in September 2008. Therefore, the final taxable income may be different than this estimate.

(2) 2006 includes the deferral of long-term capital gains through installment treatment related to the Company s sale of its control equity investment in Advantage and certain other portfolio companies.

(3) Includes taxable income (loss) passed through to the Company from Ciena Capital LLC (Ciena) in excess of interest and related portfolio income from Ciena included in the financial statements totaling ($12.0) million, $3.7 million, and $15.4 million for the years ended December 31, 2007, 2006, and 2005, respectively. See Note 3 for additional related disclosure. In the fourth quarter of 2007, Ciena made an election to be taxed prospectively as a C corporation; therefore Ciena s taxable income or losses will no longer be passed through to the Company subsequent to this election.

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 10. Dividends and Distributions and Taxes, continued

The Company must distribute at least 90% of its investment company taxable income to qualify for pass-through tax treatment and maintain its RIC status. The Company has distributed and currently intends to distribute or retain through a deemed distribution sufficient dividends to eliminate taxable income. Dividends declared and paid by the Company in a year generally differ from taxable income for that year as such dividends may include the distribution of current year taxable income, less amounts carried over into the following year, and the distribution of prior year taxable income carried over into and distributed in the current year. For income tax purposes, distributions for 2007, 2006, and 2005, were made from taxable income as follows:

($ in millions)	2007 (ESTIMATED)[1]	2006	2005
Taxable income	$ 407.6	$ 601.2	$ 445.0
Taxable income earned in current year and carried forward for distribution in next year[2]	(403.1)	(402.8)	(156.5)
Taxable income earned in prior year and carried forward and distributed in current year	402.8	156.5	26.0
Total distributions to common shareholders	$ 407.3	$ 354.9	$ 314.5

(1) The Company s taxable income for 2007 is an estimate and will not be finally determined until the Company files its 2007 tax return in September 2008. Therefore, the final taxable income and the taxable income earned in 2007 and carried forward for distribution in 2008 may be different than this estimate.

(2) Estimated taxable income for 2007 includes undistributed income of $403.1 million that is being carried over for distribution in 2008, which represents approximately $50.0 million of ordinary income and approximately $353.1 million of net long-term capital gains.

The Company will generally be required to pay an excise tax equal to 4% of the amount by which 98% of the Company s annual taxable income exceeds the distributions for the year. The Company s 2007 (estimated), 2006, and 2005, annual taxable income were in excess of its dividend distributions from such taxable income in those respective years, and accordingly, the Company had an excise tax expense of $16.3 million, $15.1 million, and $6.2 million, respectively, on the excess taxable income carried forward.

In addition to excess taxable income carried forward, the Company currently estimates that it has cumulative deferred taxable income related to installment sale gains of approximately $234.5 million as of December 31, 2007, which is composed of cumulative deferred taxable income of $211.5 million as of December 31, 2006, and approximately $23.0 million for the year ended December 31, 2007. These gains have been recognized for financial reporting purposes in the respective years they were realized, but are generally deferred for tax purposes until the notes or other amounts received from the sale of the related investments are collected in cash. The realized gains deferred through installment treatment for 2007 are estimates and will not be finally determined until the Company files its 2007 tax return in September 2008.

The Company s undistributed book earnings of $535.9 million as of December 31, 2007, resulted from undistributed ordinary income and long-term capital gains. The difference between undistributed book earnings at the end of the year and taxable income carried over from the current year into the next year relates to a variety of timing and permanent differences in the recognition of income and expenses for book and tax purposes as discussed above.

At December 31, 2007 and 2006, the aggregate gross unrealized appreciation of the Company s investments above cost for federal income tax purposes was $609.8 million (estimated) and $618.2 million,

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 10. Dividends and Distributions and Taxes, continued

respectively. At December 31, 2007 and 2006, the aggregate gross unrealized depreciation of the Company s investments below cost for federal income tax purposes was $633.1 million (estimated) and $425.0 million, respectively. The Company s investments as compared to cost for federal income tax purposes was net unrealized depreciation of $23.3 million (estimated) and net unrealized appreciation of $193.2 million at December 31, 2007 and 2006, respectively. At December 31, 2007 and 2006, the aggregate cost of securities, for federal income tax purposes was $4.8 billion (estimated) and $4.3 billion, respectively.

The Company s consolidated subsidiary, AC Corp, is subject to federal and state income taxes. For the years ended December 31, 2007, 2006, and 2005, AC Corp s income tax expense (benefit) was $(2.7) million, $(0.1) million, and $5.3 million, respectively. For the years ended December 31, 2007 and 2005, paid in capital was increased for the tax benefit of amounts deducted for tax purposes but not for financial reporting purposes primarily related to stock-based compensation by $10.9 million and $3.7 million, respectively.

The net deferred tax asset at December 31, 2007, was $18.4 million, consisting of deferred tax assets of $26.5 million and deferred tax liabilities of $8.1 million. The net deferred tax asset at December 31, 2006, was $6.9 million, consisting of deferred tax assets of $13.7 million and deferred tax liabilities of $6.8 million. At December 31, 2007, the deferred tax assets primarily related to compensation-related items and the deferred tax liabilities primarily related to depreciation. Management believes that the realization of the net deferred tax asset is more likely than not based on expectations as to future taxable income and scheduled reversals of temporary differences. Accordingly, the Company did not record a valuation allowance at December 31, 2007, 2006, or 2005.

Note 11. Cash

The Company places its cash with financial institutions and, at times, cash held in checking accounts in financial institutions may be in excess of the Federal Deposit Insurance Corporation insured limit.

At December 31, 2007 and 2006, cash consisted of the following:

($ in millions)	**2007**	**2006**
Cash	$ 4.6	$ 2.3
Less escrows held	(1.1)	(0.6)
Total cash	$ 3.5	$ 1.7

Note 12. Supplemental Disclosure of Cash Flow Information

The Company paid interest of $123.5 million, $90.6 million, and $75.2 million, respectively, for the years ended December 31, 2007, 2006, and 2005.

Non-cash operating activities for the years ended December 31, 2007, 2006 and 2005, totaled $142.2 million, $315.9 million, and $120.7 million, respectively. Non-cash operating activities for the year ended December 31, 2006, included a note received as consideration from the sale of the Company s equity investment in Advantage of $150.0 million and a note received as consideration from the sale of the Company s equity investment in STS Operating, Inc. of $30.0 million. Non-cash operating activities for the year ended December 31, 2005, included the exchange of existing subordinated debt securities and accrued interest of Ciena with a cost basis of $44.8 million for additional Class B equity interests.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 12. Supplemental Disclosure of Cash Flow Information, continued

Non-cash financing activities included the issuance of common stock in lieu of cash distributions totaling $17.1 million, $15.0 million, and $9.3 million, for the years ended December 31, 2007, 2006, and 2005, respectively. Non-cash financing activities for the year ended December 31, 2007, also included the payment of one-half of the value of the option cancellation payment in connection with the tender offer, or $52.8 million, through the issuance of 1.7 million unregistered shares of the Company s common stock. See Notes 2 and 9. Non-cash financing activities for the year ended December 31, 2005, included the issuance of $7.2 million of the Company s common stock as consideration for an additional investment in Mercury Air Centers, Inc.

Note 13. Financial Highlights

	At and for the Years Ended December 31,		
	2007	**2006**	**2005**
Per Common Share Data			
Net asset value, beginning of year	$ 19.12	$ 19.17	$ 14.87
Net investment income(1)	0.91	1.30	1.00
Net realized gains(1)(2)	1.74	3.66	1.99
Net investment income plus net realized gains(1)	2.65	4.96	2.99
Net change in unrealized appreciation or depreciation (1)(2)	(1.66)	(3.28)	3.37
Net increase in net assets resulting from operations(1)	0.99	1.68	6.36
Decrease in net assets from shareholder distributions	(2.64)	(2.47)	(2.33)
Net increase in net assets from capital share transactions (1)(3)	0.41	0.74	0.27
Decrease in net assets from cash portion of the option cancellation payment(1)(4)	(0.34)		
Net asset value, end of year	$ 17.54	$ 19.12	$ 19.17
Market value, end of year	$ 21.50	$ 32.68	$ 29.37
Total return(5)	(27.6)%	20.6%	23.5%
Ratios and Supplemental Data			
($ and shares in millions, except per share amounts)			
Ending net assets	$ 2,771.8	$ 2,841.2	$ 2,620.5
Common shares outstanding at end of year	158.0	148.6	136.7
Diluted weighted average common shares outstanding	154.7	145.6	137.3
Employee, employee stock option and administrative expenses/average net assets	6.10%	5.38%	6.56%
Total operating expenses/average net assets	10.70%	9.05%	9.99%
Net investment income/average net assets	4.91%	6.90%	6.08%
Net increase in net assets resulting from operations/ average net assets	5.34%	8.94%	38.68%
Portfolio turnover rate	26.84%	27.05%	47.72%
Average debt outstanding	$ 1,924.2	$ 1,491.0	$ 1,087.1

Average debt per share[1]	$ 12.44	$ 10.24	$ 7.92

(1) Based on diluted weighted average number of common shares outstanding for the year.

(2) Net realized gains and net change in unrealized appreciation or depreciation can fluctuate significantly from year to year.

(3) Excludes capital share transactions related to the cash portion of the option cancellation payment.

(4) See Notes 2 and 9 to the consolidated financial statements above for further discussion.

(5) Total return assumes the reinvestment of all dividends paid for the years presented.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 14. Selected Quarterly Data (Unaudited)

	2007			
($ in millions, except per share amounts)	**Qtr. 1**	**Qtr. 2**	**Qtr. 3**	**Qtr. 4**
Total interest and related portfolio income	$ 108.0	$ 117.7	$ 118.4	$ 117.7
Net investment income	$ 39.5	$ 25.2	$ 18.3	$ 58.0
Net increase (decrease) in net assets resulting from operations	$ 133.1	$ 89.2	$ (96.5)	$ 27.5
Basic earnings (loss) per common share	$ 0.89	$ 0.59	$ (0.63)	$ 0.18
Diluted earnings (loss) per common share	$ 0.87	$ 0.57	$ (0.63)	$ 0.18

	2006			
	Qtr. 1	**Qtr. 2**	**Qtr. 3**	**Qtr. 4**
Total interest and related portfolio income	$ 111.0	$ 110.5	$ 113.4	$ 117.7
Net investment income	$ 41.3	$ 50.2	$ 48.7	$ 49.1
Net increase in net assets resulting from operations	$ 99.6	$ 33.7	$ 77.9	$ 33.9
Basic earnings per common share	$ 0.72	$ 0.24	$ 0.54	$ 0.23
Diluted earnings per common share	$ 0.70	$ 0.24	$ 0.53	$ 0.23

Note 15. Litigation

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

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

In late December 2006, the Company received a subpoena from the U.S. Attorney for the District of Columbia requesting, among other things, the production of records regarding the use of private investigators by the Company or its agents. The Board established a committee, which was advised by its own counsel, to review this matter. In the course of gathering documents responsive to the subpoena, the

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 15. Litigation, continued

Company became aware that an agent of the Company obtained what were represented to be telephone records of David Einhorn and which purport to be records of calls from Greenlight Capital during a period of time in 2005. Also, while the Company was gathering documents responsive to the subpoena, allegations were made that the Company s management had authorized the acquisition of these records and that management was subsequently advised that these records had been obtained. The Company s management has stated that these allegations are not true. The Company has cooperated fully with the inquiry by the U.S. Attorney s Office.

On February 13, 2007, Rena Nadoff filed a shareholder derivative action in the Superior Court of the District of Columbia, captioned Rena Nadoff v. Walton, et al., CA 001060-07, seeking unspecified compensatory and other damages, as well as equitable relief on behalf of Allied Capital Corporation. The complaint was summarily dismissed in July 2007. The complaint alleged breach of fiduciary duty by the Board of Directors arising from internal control failures and mismanagement of Business Loan Express, LLC, an Allied Capital portfolio company. On October 5, 2007, Rena Nadoff sent a letter to the Company s Board of Directors with substantially the same claims and a request that the Board of Directors investigate the claims and take appropriate action. The Board of Directors has established a committee, which is advised by its own counsel, to review the matter.

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

In addition, the Company is party to certain lawsuits in the normal course of business.

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

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders
Allied Capital Corporation:

Under date of February 28, 2008, we reported on the consolidated balance sheet of Allied Capital Corporation and subsidiaries as of December 31, 2007 and 2006, including the consolidated statements of investments as of December 31, 2007 and 2006, and the related consolidated statements of operations, changes in net assets and cash flows, and the financial highlights (included in Note 13), for each of the years in the three-year period ended December 31, 2007, which are included in this registration statement. In connection with our audits of the aforementioned consolidated financial statements, we also audited the related financial statement schedule as of and for the year ended December 31, 2007. This financial statement schedule is the responsibility of the Company s management. Our responsibility is to express an opinion on this financial statement schedule based on our audit.

In our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects the information set forth therein.

Washington, D.C.
February 28, 2008

Schedule 12-14

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
SCHEDULE OF INVESTMENTS IN AND ADVANCES TO AFFILIATES

PRIVATE FINANCE Portfolio Company (in thousands)	**Investment[1]**	Amount of Interest or Dividends Credited to Income[6]	Other[2]	December 31, 2006 Value	Gross Additions[3]	Gross Reductions[4]	December 31, 2007 Value
Companies More Than 25% Owned							
Alaris Consulting, LLC	Senior Loan[5]			$	$ 572	$ (572)	$
(Business Services)	Equity Interests				1,025	(1,025)	
AllBridge Financial, LLC (Financial Services)	Equity Interests				7,800		7,800
Allied Capital Senior Debt Fund, L.P. (Private Debt Fund)	Equity Interests				32,811		32,811
Avborne, Inc.	Preferred Stock			918	715		1,633
(Business Services)	Common Stock						
Avborne Heavy Maintenance, Inc.	Preferred Stock				2,557		2,557
(Business Services)	Common Stock				370		370
Aviation Properties Corporation (Business Services)	Common Stock				65	(65)	

Border Foods, Inc. (Consumer Products)	Preferred Stock				4,648		4,648
	Common Stock						
Calder Capital Partners, LLC (Financial Services)	Senior Loan[5]		$ 46	975	2,189	(129)	3,035
	Equity Interests			2,076	1,483		3,559
Callidus Capital Corporation (Financial Services)	Senior Loan	$ 42			2,100	(2,100)	
	Subordinated Debt	1,159		5,762	1,109		6,871
	Common Stock			22,550	22,037		44,587
Ciena Capital LLC (f/k/a Business Loan Express, LLC) (Financial Services)	Class A Equity Interests[5]			66,622	32,422	(30,435)	68,609
	Class B Equity Interests			79,139		(79,139)	
	Class C Equity Interests			64,976		(64,976)	
CitiPostal Inc.[9] (Business Services)	Senior Loan	2			679		679
	Unitranche Debt	187			50,597		50,597
	Subordinated Debt	39			8,049		8,049
	Common Stock				12,726		12,726
Coverall North America, Inc. (Business Services)	Unitranche Debt	4,324		36,333	36	(1,446)	34,923
	Subordinated Debt	919		5,972	7		5,979
	Common Stock			19,619	7,978		27,597
CR Holding, Inc. (Consumer Products)	Subordinated Debt	6,838		39,401	1,411		40,812
	Common Stock			25,738	15,196		40,934
Direct Capital Corporation	Subordinated Debt	5,027			39,030		39,030
	Common Stock				19,250	(12,344)	6,906

(Financial Services)

Financial Pacific Company (Financial Services)	Subordinated Debt	12,663	71,362	1,488		72,850
	Preferred Stock		15,942	3,388		19,330
	Common Stock		65,186		(26,642)	38,544
ForeSite Towers, LLC (Tower Leasing)	Equity Interest	1,269	12,290		(11,412)	878
Global Communications, LLC (Business Services)	Senior Loan[5]		15,957		(14,135)	1,822
	Subordinated Debt	3	11,237	99	(11,336)	
	Preferred Equity Interest			14,067	(14,067)	
	Options			1,639	(1,639)	
Gordian Group, Inc. (Business Services)	Senior Loan	(11)		11,794	(11,794)	
	Common Stock			6,942	(6,942)	
Healthy Pet Corp. (Consumer Services)	Senior Loan	1,309	27,038	6,350	(33,388)	
	Subordinated Debt	2,893	43,579	580	(44,159)	
	Common Stock		28,921	1,221	(30,142)	
HMT, Inc. (Energy Services)	Preferred Stock		2,637		(2,637)	
	Common Stock		8,664		(8,664)	
	Warrants		3,336		(3,336)	

See related footnotes at the end of this schedule.

PRIVATE FINANCE Portfolio Company (in thousands)	Investment[1]	Amount of Interest or Dividends Credited to Income[6]	Other[2]	December 31, 2006 Value	Gross Additions[3]	Gross Reductions[4]	December 31, 2007 Value
Hot Stuff Foods, LLC[7] (Consumer Products)	Senior Loan	$ 4,191	$		$51,192	$ (440)	$ 50,752
	Subordinated Debt	6,543			29,907		29,907
	Subordinated Debt [5]				31,402	(30,065)	1,337
	Common Stock				8,461	(8,461)	
Huddle House, Inc. (Retail)	Senior Loan	426		19,950		(19,950)	
	Subordinated Debt	9,032		58,196	1,600	(178)	59,618
	Common Stock			41,662	2,621	(129)	44,154
Impact Innovations Group, LLC (Business Services)	Equity Interests in Affiliate			873		(553)	320
Insight Pharmaceuticals Corporation (Consumer Products)	Subordinated Debt	5,905		43,884	1,157		45,041
	Subordinated Debt [5]			15,966	830		16,796
	Preferred Stock			7,845		(6,383)	1,462
	Common Stock						
Jakel, Inc. (Industrial Products)	Subordinated Debt [5]	(11)		6,655	9,025	(14,117)	1,563
	Preferred Stock				9,347	(9,347)	
	Common Stock				6,460	(6,460)	
Legacy Partners Group, Inc. (Financial Services)	Senior Loan [5]			4,843	2,804	(3,804)	3,843
	Subordinated Debt						
	Equity Interests				1,332		1,332

Litterer Beteiligungs-GmbH (Business Services)	Subordinated Debt	42	692	80		772
	Equity Interest		1,199		(499)	700
Mercury Air Centers, Inc. (Business Services)	Subordinated Debt	5,054	49,217	1,654	(50,871)	
	Common Stock		195,019		(195,019)	
MVL Group, Inc. (Business Services)	Senior Loan	3,677	27,245	3,394		30,639
	Subordinated Debt	5,931	35,478	4,465		39,943
	Common Stock			4,949		4,949
Old Orchard Brands, LLC (Consumer Products)	Senior Loan	347		23,500	(23,500)	
	Subordinated Debt	2,404		19,544		19,544
	Equity Interests			25,419		25,419
Penn Detroit Diesel Allison, LLC (Business Services)	Subordinated Debt	6,056	37,994	1,186		39,180
	Equity Interests		25,949	12,016		37,965
Powell Plant Farms, Inc. (Consumer Products)	Senior Loan(5)		26,192	4,134	(28,792)	1,534
	Subordinated Debt		962	18,261	(19,223)	
	Preferred Stock					
	Warrants					
Service Champ, Inc. (Business Services)	Subordinated Debt	4,450	27,619	732		28,351
	Common Stock		16,786	9,506		26,292
Staffing Partners Holding Company, Inc. (Business Services)	Subordinated Debt (5)		486		(263)	223
Startec Global Communications Corporation	Senior Loan	723	15,965		(15,965)	

(Telecommunications)	Common Stock		11,232	26,023	(37,255)	
Startec Equity, LLC (Telecommunications)	Equity Interests			469	(39)	430
Sweet Traditions, Inc. (Retail)	Senior Loan[5]	1,088	35,172	1,181	(1,124)	35,229
	Preferred Stock		400	550	(950)	
	Common Stock		50		(50)	
Triview Investments, Inc. (Broadcasting & Cable/ Business Services/ Consumer Products)	Senior Loan	977	14,747	11	(14,325)	433
	Subordinated Debt	11,338	56,008	32,425	(45,456)	42,977
	Subordinated Debt [5]	592	4,342	841	(3,600)	1,583
	Common Stock	37	31,322	53,975	(1,844)	83,453
Unitranche Fund LLC (Private Debt Fund)	Subordinated Certificates	3		744		744
	Equity Interests			1		1
Worldwide Express Operations, LLC (Business Services)	Subordinated Debt	166		2,846	(176)	2,670
	Equity Interests			21,516		21,516
	Warrants			272		272
Total companies more than 25% owned		**$105,634**	**$1,490,180**			**$1,279,080**

See related footnotes at the end of this schedule.

PRIVATE FINANCE Portfolio Company (in thousands)	Investment[1]	Amount of Interest or Dividends Credited to Income[6]	Other[2]	December 31, 2006 Value	Gross Additions[3]	Gross Reductions[4]	December 31, 2007 Value
Companies 5% to 25% Owned							
10th Street, LLC (Business Services)	Subordinated Debt	$ 457		$ 2,289	$20,647	$ (2,291)	$ 20,645
	Equity Interests			2,250	679	(1,829)	1,100
Advantage Sales & Marketing, Inc. (Business Services)	Subordinated Debt	18,768		151,648	3,206		154,854
	Equity Interests			11,000		(27)	10,973
Air Medical Group Holdings LLC (Healthcare Services)	Senior Loan	219		1,763	7,367	(6,150)	2,980
	Subordinated Debt	1,931		35,128	318	(35,446)	
	Equity Interests			5,950	4,850		10,800
Alpine ESP Holdings, Inc. (Business Services)	Preferred Stock			602	147		749
	Common Stock				262		262
Amerex Group, LLC (Consumer Products)	Subordinated Debt	1,022		8,400			8,400
	Equity Interests			13,823		(110)	13,713
BB&T Capital Partners/Windsor Mezzanine Fund, LLC (Private Equity Fund)	Equity Interests			5,554	5,913		11,467

Becker Underwood, Inc. (Industrial Products)	Subordinated Debt	3,636	24,163	635		24,798
	Common Stock		3,700	490		4,190
BI Incorporated (Business Services)	Subordinated Debt	4,197	30,135	364		30,499
	Common Stock		4,100	3,282		7,382
CitiPostal, Inc. and Affiliates[9] (Business Services)	Senior Loan	2,012	18,280	2,894	(21,174)	
	Equity Interests	105	2,450	183	(2,633)	
Creative Group, Inc. (Business Services)	Subordinated Debt [5]	480	13,656	30	(7,489)	6,197
	Common Stock Warrant		1,387		(1,387)	
Drew Foam Companies, Inc. (Business Services)	Preferred Stock		722		(326)	396
	Common Stock		7		(7)	
MedBridge Healthcare, LLC (Healthcare Services)	Senior Loan[5]		7,164			7,164
	Subordinated Debt [5]		1,813	593		2,406
	Convertible Subordinated Debt [5]					
	Equity Interests			110	(110)	
MHF Logistical Solutions, Inc[8] (Business Services)	Subordinated Debt [5]			27,518	(18,238)	9,280
	Subordinated Debt [5]					
	Common Stock Warrants					
Multi-Ad Services, Inc. (Business Services)	Unitranche Debt	2,292	19,879	25	(200)	19,704
	Equity Interests		2,000		(1,060)	940
Nexcel Synthetics, LLC	Subordinated Debt	611	10,978	199	(11,177)	

(Consumer Products)	Equity Interests		1,486	269	(1,755)	
PresAir LLC	Senior Loan	28	2,206	3,315	(5,521)	
(Industrial Products)	Equity Interests			1,341	(1,341)	
Progressive International Corporation	Subordinated Debt	995	7,533	151	(6,139)	1,545
(Consumer Products)	Preferred Stock		1,024	14		1,038
	Common Stock		2,300	2,600		4,900
	Warrants					
Regency Healthcare Group, LLC	Senior Loan	96	1,232	18	(1,250)	
(Healthcare Services)	Unitranche Debt	1,791	19,908	47	(8,014)	11,941
	Equity Interests		1,616	65		1,681
SGT India Private Limited (Business Services)	Common Stock		3,346	155	(426)	3,075
Soteria Imaging Services, LLC	Subordinated Debt	2,122	17,569	1,175	(5,000)	13,744
(Healthcare Services)	Equity Interests		2,541	145		2,686
Universal Environmental Services, LLC	Unitranche Debt	815	10,211	777	(10,988)	
(Business Services)	Equity Interests			15	(15)	
Total companies 5% to 25% owned		**$41,577**	**$449,813**			**$389,509**

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

(1) Common stock, preferred stock, warrants, options, and equity interests are generally non-income producing and restricted. The principal amount for loans and debt securities and the number of shares of common stock and

preferred stock is shown in the consolidated statement of investments as of December 31, 2007.

(2) Other includes interest, dividend, or other income which was applied to the principal of the investment and therefore reduced the total investment. These reductions are also included in the Gross Reductions for the investment, as applicable.

(3) Gross additions include increases in the cost basis of investments resulting from new portfolio investments, paid-in-kind interest or dividends, the amortization of discounts and closing fees, the exchange of one or more existing securities for one or more new securities and the movement of an existing portfolio company into this category from a different category. Gross additions also include net increases in unrealized appreciation or net decreases in unrealized depreciation.

(4) Gross reductions include decreases in the cost basis of investments resulting from principal collections related to investment repayments or sales, the exchange of one or more existing securities for one or more new securities and the movement of an existing portfolio company out of this category into a different category. Gross reductions also include net increases in unrealized depreciation or net decreases in unrealized appreciation.

(5) Loan or debt security is on non-accrual status at December 31, 2007, and is therefore considered non-income producing. Loans or debt securities on non-accrual status at the end of the period may or may not have been on non-accrual status for the full period.

(6) Represents the total amount of interest or dividends credited to income for the portion of the year an investment was included in the companies more than 25% owned or companies 5% to 25% owned categories, respectively.

(7) In the first quarter of 2007, the Company exercised its option to acquire a majority of the voting securities of Hot Stuff Foods, LLC (Hot Stuff) at fair market value. Therefore, Hot Stuff was reclassified to companies more than 25% owned in the first quarter of 2007. At December 31, 2006, the Company s investment in Hot Stuff was included in the companies less than 5% owned category.

(8) In the second quarter of 2007, the Company obtained a seat on the board of directors of MHF Logistical Solutions, Inc. (MHF). Therefore, MHF was reclassified to companies 5% to 25% owned in the second quarter of 2007. At December 31, 2006, the Company s investment in MHF was included in the companies less than 5% owned category.

(9) In December 2007, the Company acquired the majority ownership of CitiPostal Inc.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders
Allied Capital Corporation:

We have reviewed the accompanying consolidated balance sheet of Allied Capital Corporation and subsidiaries (the Company), including the consolidated statement of investments, as of March 31, 2008, the related consolidated statements of operations, changes in net assets and cash flows and the financial highlights (included in Note 12) for the three-month periods ended March 31, 2008 and 2007. These consolidated financial statements and financial highlights are the responsibility of the Company s management.

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

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

We have previously audited, in accordance with standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Allied Capital Corporation and subsidiaries, including the consolidated statement of investments, as of December 31, 2007, and the related consolidated statements of operations, changes in net assets and cash flows (not presented herein), and the financial highlights, for the year then ended; and in our report dated February 28, 2008, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet including the consolidated statement of investments as of December 31, 2007, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

Washington, D.C.
May 9, 2008

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET

(in thousands, except per share amounts)	March 31, 2008 (unaudited)	December 31, 2007
ASSETS		
Portfolio at value:		
Private finance		
Companies more than 25% owned (cost: 2008-$1,656,009; 2007-$1,622,094)	$ 1,157,473	$ 1,279,080
Companies 5% to 25% owned (cost: 2008-$361,410; 2007-$426,908)	381,758	389,509
Companies less than 5% owned (cost: 2008-$3,001,894; 2007-$2,994,880)	2,980,548	2,990,732
Total private finance (cost: 2008-$5,019,313; 2007-$5,043,882)	4,519,779	4,659,321
Commercial real estate finance (cost: 2008-$89,707; 2007-$96,942)	115,854	121,200
Total portfolio at value (cost: 2008-$5,109,020; 2007-$5,140,824)	4,635,633	4,780,521
Investments in U.S. Treasury bills, money market and other securities	120,406	201,222
Accrued interest and dividends receivable	73,709	71,429
Other assets	171,327	157,864
Cash	81,167	3,540
Total assets	$ 5,082,242	$ 5,214,576
LIABILITIES AND SHAREHOLDERS EQUITY		
Liabilities:		
Notes payable and debentures (maturing within one year: 2008-$170,813; 2007-$153,000)	$ 1,922,813	$ 1,922,220
Revolving line of credit	268,750	367,250
Accounts payable and other liabilities	62,261	153,259
Total liabilities	2,253,824	2,442,729
Commitments and contingencies		
Shareholders equity:		
Common stock, $0.0001 par value, 400,000 shares authorized; 166,472 and 158,002 shares issued and outstanding at March 31, 2008, and December 31, 2007, respectively	16	16
Additional paid-in capital	2,823,218	2,657,939
Common stock held in deferred compensation trusts		(39,942)
Notes receivable from sale of common stock	(2,549)	(2,692)
Net unrealized appreciation (depreciation)	(492,731)	(379,327)
Undistributed earnings	500,464	535,853
Total shareholders equity	2,828,418	2,771,847

Total liabilities and shareholders equity	$	5,082,242	$	5,214,576
Net asset value per common share	$	16.99	$	17.54

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 March 31, 2008	2007
	(unaudited)	
Interest and Related Portfolio Income:		
Interest and dividends		
Companies more than 25% owned	$ 28,624	$ 27,157
Companies 5% to 25% owned	12,674	11,861
Companies less than 5% owned	93,362	62,965
Total interest and dividends	134,660	101,983
Fees and other income		
Companies more than 25% owned	5,465	3,989
Companies 5% to 25% owned	53	28
Companies less than 5% owned	4,766	1,952
Total fees and other income	10,284	5,969
Total interest and related portfolio income	144,944	107,952
Expenses:		
Interest	37,560	30,288
Employee	22,652	21,928
Employee stock options	4,195	3,661
Administrative	9,019	13,224
Total operating expenses	73,426	69,101
Net investment income before income taxes	71,518	38,851
Income tax expense (benefit), including excise tax	1,969	(649)
Net investment income	69,549	39,500
Net Realized and Unrealized Gains (Losses):		
Net realized gains (losses)		
Companies more than 25% owned	(303)	(1,350)
Companies 5% to 25% owned	1,243	166
Companies less than 5% owned	2,203	28,850
Total net realized gains	3,143	27,666
Net change in unrealized appreciation or depreciation	(113,404)	65,920

Total net gains (losses)	(110,261)	93,586
Net increase (decrease) in net assets resulting from operations	$ (40,712)	$ 133,086
Basic earnings (loss) per common share	$ (0.25)	$ 0.89
Diluted earnings (loss) per common share	$ (0.25)	$ 0.87
Weighted average common shares outstanding basic	161,507	149,503
Weighted average common shares outstanding diluted	161,507	152,827

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 Three Months Ended March 31, 2008	2007
	(unaudited)	
Operations:		
Net investment income	$ 69,549	$ 39,500
Net realized gains	3,143	27,666
Net change in unrealized appreciation or depreciation	(113,404)	65,920
Net increase (decrease) in net assets resulting from operations	(40,712)	133,086
Shareholder distributions:		
Common stock dividends	(108,081)	(95,753)
Net decrease in net assets resulting from shareholder distributions	(108,081)	(95,753)
Capital share transactions:		
Sale of common stock	170,883	93,784
Issuance of common stock in lieu of cash distributions	3,751	4,266
Issuance of common stock upon the exercise of stock options		1,366
Stock option expense	4,195	3,661
Net decrease in notes receivable from sale of common stock	143	135
Purchase of common stock held in deferred compensation trusts	(943)	(3,089)
Distribution of common stock held in deferred compensation trusts	27,335	53
Other		(476)
Net increase in net assets resulting from capital share transactions	205,364	99,700
Total increase in net assets	56,571	137,033
Net assets at beginning of period	2,771,847	2,841,244
Net assets at end of period	$ 2,828,418	$ 2,978,277
Net asset value per common share	$ 16.99	$ 19.58
Common shares outstanding at end of period	166,472	152,124

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOWS

(in thousands)	For the Three Months Ended March 31, 2008	2007
	(unaudited)	
Cash flows from operating activities:		
Net increase (decrease) in net assets resulting from operations	$ (40,712)	$ 133,086
Adjustments:		
Portfolio investments	(275,130)	(170,216)
Principal collections related to investment repayments or sales	264,777	235,509
Payment-in-kind interest and dividends, net of cash collections	(13,392)	(8,143)
Change in accrued interest and dividends	(2,280)	(3,124)
Net collection (amortization) of discounts and fees	(3,748)	(1,844)
Redemption of (investments in) U.S. Treasury bills, money market and other securities	80,834	(66,335)
Stock option expense	4,195	3,661
Changes in other assets and liabilities	(46,218)	(40,453)
Depreciation and amortization	528	507
Realized gains from the receipt of notes and other consideration from sale of investments, net of collections	(565)	(2,814)
Realized losses	29,597	5,515
Net change in unrealized (appreciation) or depreciation	113,404	(65,920)
Net cash provided by operating activities	111,290	19,429
Cash flows from financing activities:		
Sale of common stock	170,883	93,784
Sale of common stock upon the exercise of stock options		1,366
Collections of notes receivable from sale of common stock	143	135
Borrowings under notes payable		200,000
Net borrowings under (repayments on) revolving line of credit	(98,500)	(207,750)
Purchase of common stock held in deferred compensation trusts	(943)	(3,089)
Other financing activities	(916)	(6,325)
Common stock dividends and distributions paid	(104,330)	(98,910)
Net cash provided by (used in) financing activities	(33,663)	(20,789)
Net increase (decrease) in cash	77,627	(1,360)
Cash at beginning of period	3,540	1,687
Cash at end of period	$ 81,167	$ 327

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF INVESTMENTS

Private Finance Portfolio Company (in thousands, except number of shares)	Investment[1][2]	Principal	March 31, 2008 (unaudited) Cost	Value
Companies More Than 25% Owned				
AGILE Fund I, LLC[5]	Equity Interests		$ 860	$ 860
(Private Equity Fund)	**Total Investment**		**860**	**860**
Alaris Consulting, LLC	Senior Loan (16.5%, Due 12/05 12/07)[6]	$ 27,055	26,986	
(Business Services)	Equity Interests		6,400	
	Total Investment		**33,386**	
	Guaranty ($1,100)			
	Standby Letters of Credit ($231)			
AllBridge Financial, LLC	Equity Interests		21,744	15,470
(Asset Management)	**Total Investment**		**21,744**	**15,470**
	Standby Letter of Credit ($30,000)			
Allied Capital Senior Debt Fund, L.P. [5]	Equity Interests (See Note 3)		31,800	32,605
(Private Debt Fund)	**Total Investment**		**31,800**	**32,605**
Avborne, Inc.[7]	Preferred Stock (12,500 shares)		611	1,684
(Business Services)	Common Stock (27,500 shares)			
	Total Investment		**611**	**1,684**
Avborne Heavy Maintenance, Inc.[7]	Preferred Stock (1,568 shares)			157
(Business Services)	Common Stock (2,750 shares)			1,037

	Total Investment			**1,194**
Aviation Properties Corporation	Common Stock (100 shares)		65	
(Business Services)	**Total Investment**		**65**	
	Standby Letters of Credit ($1,000)			
Border Foods, Inc.	Preferred Stock (100,000 shares)		12,721	3,141
(Consumer Products)	Common Stock (148,838 shares)		3,847	
	Total Investment		**16,568**	**3,141**
Calder Capital Partners, LLC[5]	Senior Loan (9.4%, Due 5/09)[6]	2,880	2,880	3,073
(Asset Management)	Equity Interests		2,397	3,534
	Total Investment		**5,277**	**6,607**
Callidus Capital Corporation	Senior Loan (12.0%, Due 12/08)	1,500	1,500	1,500
(Asset Management)	Subordinated Debt (16.6%, Due 10/08 2/14)	11,180	11,180	11,180
	Common Stock (100 shares)		2,067	40,022
	Total Investment		**14,747**	**52,702**

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

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

(5) Non-registered investment company.

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

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

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

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

Private Finance Portfolio Company (in thousands, except number of shares)	**Investment[1][2]**	**Principal**	**Cost**	**Value**
		March 31, 2008 (unaudited)		
Ciena Capital LLC (Financial Services)	Class A Equity Interests (25.0% See Note 3)[6]	$ 99,044	$ 99,044	$ 29,291
	Class B Equity Interests		119,436	
	Class C Equity Interests		109,301	
	Total Investment		**327,781**	**29,291**
	Guaranty ($384,819 See Note 3)			
	Standby Letters of Credit ($59,500 See Note 3)			
CitiPostal Inc. (Business Services)	Senior Loan (6.1%, Due 12/13)	691	680	680
	Unitranche Debt (12.0%, Due 12/13)	51,369	51,126	51,126
	Subordinated Debt (16.0%, Due 12/15)	8,092	8,092	8,092
	Common Stock (37,024 shares)		12,726	16,777
	Total Investment		**72,624**	**76,675**
Coverall North America, Inc. (Business Services)	Unitranche Debt (12.0%, Due 7/11)	32,035	31,923	31,923
	Subordinated Debt (15.0%, Due 7/11)	5,563	5,545	5,545
	Common Stock (763,333 shares)		14,362	28,008
	Total Investment		**51,830**	**65,476**
CR Holding, Inc. (Consumer Products)	Subordinated Debt (16.6%, Due 2/13)	38,306	38,180	38,180
	Common Stock (32,090,696 shares)		28,744	27,482
	Total Investment		**66,924**	**65,662**
Crescent Equity Corp.[8] (Business Services/	Senior Loan (10.0%, Due 12/07)	433	433	433
	Subordinated Debt (11.0%, Due 1/10 6/17)	31,095	30,979	30,979
Broadcasting & Cable)	Subordinated Debt (12.5%, Due 11/07 3/08)[6]	1,450	1,450	1,683

	Common Stock (174 shares)		80,571	24,313
	Total Investment		**113,433**	**57,408**
	Guaranty ($900)			
	Standby Letters of Credit ($200)			
Direct Capital Corporation	Subordinated Debt (16.0%, Due 3/13)	49,841	49,706	49,706
(Financial Services)	Common Stock (1,809,159 shares)		22,644	11,006
	Total Investment		**72,350**	**60,712**
Financial Pacific Company	Subordinated Debt (17.4%, Due 2/12 8/12)	68,056	67,898	67,898
(Financial Services)	Preferred Stock (9,458 shares)		8,865	17,551
	Common Stock (12,711 shares)		12,783	24,021
	Total Investment		**89,546**	**109,470**

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

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

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

(8) Crescent Equity Corp. had a cost basis of $113.4 million and holds investments in Crescent Hotels & Resorts, LLC and affiliates (Business Services) with a value of $54.9 million, and Longview Cable & Data, LLC (Broadcasting & Cable) with a value of $2.6 million, for a total value of $57.4 million.

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	Cost	Value
			March 31, 2008 (unaudited)	
ForeSite Towers, LLC	Equity Interest		$	$ 803
(Tower Leasing)	**Total Investment**			**803**
Global Communications, LLC	Senior Loan (10.0%, Due 9/02)[6]	$ 1,350	1,350	1,350
(Business Services)	**Total Investment**		**1,350**	**1,350**
Hot Light Brands, Inc.	Senior Loan (9.0%, Due 2/11)[6]	29,277	29,277	29,628
(Retail)	Common Stock (93,500 shares)		5,151	1,150
	Total Investment		**34,428**	**30,778**
Hot Stuff Foods, LLC	Senior Loan (6.2%, Due 2/11-2/12)	52,414	52,238	52,238
(Consumer Products)	Subordinated Debt (9.9%, Due 8/12)	30,540	30,452	20,399
	Subordinated Debt (15.4%, Due 2/13)[6]	52,373	52,151	
	Common Stock (1,147,453 shares)		56,187	
	Total Investment		**191,028**	**72,637**
Huddle House, Inc.	Subordinated Debt (15.0%, Due 12/12)	55,927	55,717	55,717
(Retail)	Common Stock (358,428 shares)		35,828	36,824
	Total Investment		**91,545**	**92,541**
Impact Innovations Group, LLC	Equity Interests in Affiliate			321
(Business Services)	**Total Investment**			**321**
Insight Pharmaceuticals Corporation	Subordinated Debt (15.0%, Due 9/12)	45,554	45,441	45,441
(Consumer Products)	Subordinated Debt (19.0%, Due 9/12)[6]	16,181	16,130	16,967

	Preferred Stock (25,000 shares)		25,000	10,561
	Common Stock (620,000 shares)		6,325	
	Total Investment		**92,896**	**72,969**
Jakel, Inc.	Subordinated Debt (15.5%, Due 3/08)[6]	748	748	748
(Industrial Products)	**Total Investment**		**748**	**748**
Legacy Partners Group, Inc.	Senior Loan (14.0%, Due 5/09)[6]	843	843	843
(Financial Services)	Equity Interests		4,261	1,145
	Total Investment		**5,104**	**1,988**
Litterer Beteiligungs-GmbH[4]	Subordinated Debt (8.0%, Due 3/07)	828	828	828
(Business Services)	Equity Interest		1,809	850
	Total Investment		**2,637**	**1,678**

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

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

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

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

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]	March 31, 2008 (unaudited) Principal	Cost	Value
MHF Logistical Solutions, Inc. (Business Services)	Subordinated Debt (13.0%, Due 6/12 6/13)[6]	$ 49,841	$ 49,613	$ 9,319
	Preferred Stock (10,000 shares)			
	Common Stock (20,934 shares)		20,942	
	Total Investment		**70,555**	**9,319**
MVL Group, Inc.	Senior Loan (12.0%, Due 6/09 7/09)	30,674	30,645	30,645
(Business Services)	Subordinated Debt (14.5%, Due 6/09 7/09)	40,447	40,239	40,239
	Common Stock (559,377 shares)		555	4,373
	Total Investment		**71,439**	**75,257**
Old Orchard Brands, LLC	Subordinated Debt (18.0%, Due 7/14)	18,402	18,325	18,325
(Consumer Products)	Equity Interests		15,857	25,302
	Total Investment		**34,182**	**43,627**
Penn Detroit Diesel Allison, LLC	Subordinated Debt (15.5%, Due 8/13)	37,145	37,011	37,011
(Business Services)	Equity Interests		18,850	33,522
	Total Investment		**55,861**	**70,533**
Service Champ, Inc.	Subordinated Debt (15.5%, Due 4/12)	26,542	26,461	26,461
(Business Services)	Common Stock (55,112 shares)		11,785	23,751
	Total Investment		**38,246**	**50,212**

Startec Equity, LLC	Equity Interests		191	397
(Telecommunications)	**Total Investment**		**191**	**397**
Sweet Traditions, Inc.	Senior Loan (10.0%, Due 9/08)[6]	694	694	427
(Retail)	**Total Investment**		**694**	**427**
Unitranche Fund LLC	Subordinated Certificates (12.4)%		31,491	31,491
(Private Debt Fund)	Equity Interests		1	1
	Total Investment		**31,492**	**31,492**
Worldwide Express Operations, LLC	Subordinated Debt (14.0%, Due 2/14)	2,695	2,539	2,539
(Business Services)	Equity Interests		11,384	18,664
	Warrants		144	236
	Total Investment		**14,067**	**21,439**
Total companies more than 25% owned			**$ 1,656,009**	**$ 1,157,473**

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

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

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

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	March 31, 2008 (unaudited) Cost	Value
Companies 5% to 25% Owned				
10(th) Street, LLC	Subordinated Debt (13.0%, Due 11/14)	$ 20,774	$ 20,650	$ 20,774
(Business Services)	Equity Interests		421	1,075
	Option		25	25
	Total Investment		**21,096**	**21,874**
Advantage Sales & Marketing, Inc.	Subordinated Debt (12.0%, Due 3/14)	156,218	155,663	157,443
(Business Services)	Equity Interests			10,200
	Total Investment		**155,663**	**167,643**
Air Medical Group Holdings LLC	Senior Loan (5.2%, Due 3/11)	4,023	3,977	3,865
(Healthcare Services)	Equity Interests		2,993	9,900
	Total Investment		**6,970**	**13,765**
Alpine ESP Holdings, Inc.	Preferred Stock (536 shares)		536	622
(Business Services)	Common Stock (11,657 shares)		12	
	Total Investment		**548**	**622**
Amerex Group, LLC	Subordinated Debt (12.0%, Due 1/13)	7,789	7,789	7,789
(Consumer Products)	Equity Interests		3,509	12,772
	Total Investment		**11,298**	**20,561**
BB&T Capital Partners/ Windsor Mezzanine Fund, LLC[5]	Equity Interests		11,739	11,475

(Private Equity Fund)	**Total Investment**		**11,739**	**11,475**
Becker Underwood, Inc.	Subordinated Debt (14.5%, Due 8/12)	25,023	24,960	25,524
(Industrial Products)	Common Stock (4,376 shares)		5,014	4,000
	Total Investment		**29,974**	**29,524**
BI Incorporated	Subordinated Debt (13.5%, Due 2/14)	30,615	30,504	30,921
(Business Services)	Common Stock (34,506 shares)		3,451	6,200
	Total Investment		**33,955**	**37,121**
Creative Group, Inc.	Subordinated Debt (14.0%, Due 9/13)(6)	15,000	13,686	5,185
(Business Services)	Common Stock (20,000 shares)			
	Warrant		1,387	
	Total Investment		**15,073**	**5,185**
Drew Foam Companies, Inc.	Preferred Stock (622,555 shares)		623	270
(Business Services)	Common Stock (6,286 shares)		6	
	Total Investment		**629**	**270**

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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**	**Cost**	**Value**
		March 31, 2008 (unaudited)		
Hilden America, Inc.	Common Stock (19 shares)		$ 454	$ 445
(Consumer Products)	**Total Investment**		**454**	**445**
MedBridge Healthcare, LLC	Senior Loan (8.0%, Due 8/09)[6]	$ 7,164	7,164	7,164
(Healthcare Services)	Subordinated Debt (10.0%, Due 8/14)[6]	5,184	5,184	2,601
	Convertible Subordinated Debt (2.0%, Due 8/14) [6]	2,970	984	
	Equity Interests		1,416	
	Total Investment		**14,748**	**9,765**
Multi-Ad Services, Inc.	Unitranche Debt (11.3%, Due 11/11)	19,750	19,660	19,732
(Business Services)	Equity Interests		1,725	1,014
	Total Investment		**21,385**	**20,746**
Progressive International Corporation	Subordinated Debt (16.0%, Due 12/09)	1,576	1,565	1,576
(Consumer Products)	Preferred Stock (500 shares)		500	1,059
	Common Stock (197 shares)		13	5,800
	Warrants			
	Total Investment		**2,078**	**8,435**
Regency Healthcare Group, LLC	Unitranche Debt (11.1%, Due 6/12)	12,000	11,944	12,297
(Healthcare Services)	Equity Interests		1,294	1,497
	Total Investment		**13,238**	**13,794**
SGT India Private Limited[4]	Common Stock (150,596 shares)		4,099	2,580

(Business Services)	**Total Investment**		**4,099**	**2,580**
Soteria Imaging Services, LLC	Subordinated Debt (11.9%, Due 11/10)	15,750	15,029	15,750
(Healthcare Services)	Equity Interests		1,872	2,203
	Total Investment		**16,901**	**17,953**
Universal Environmental Services, LLC	Equity Interests		1,562	
(Business Services)	**Total Investment**		**1,562**	
Total companies 5% to 25% owned			**$ 361,410**	**$ 381,758**
Companies Less Than 5% Owned				
3SI Security Systems, Inc.	Subordinated Debt (14.5%, Due 8/13)	$ 28,234	$ 28,139	$ 27,836
(Consumer Products)	**Total Investment**		**28,139**	**27,836**
AgData, L.P.	Senior Loan (10.3%, Due 7/12)	1,843	1,836	1,862
(Consumer Services)	Unitranche Debt (10.3%, Due 7/12)	4,120	4,080	4,161
	Total Investment		**5,916**	**6,023**

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

		March 31, 2008		
		(unaudited)		
Private Finance Portfolio Company (in thousands, except number of shares)	**Investment[1][2]**	**Principal**	**Cost**	**Value**
Augusta Sportswear Group, Inc.	Subordinated Debt (13.0%, Due 1/15)	$ 53,000	$ 52,807	$ 52,807
(Consumer Products)	Common Stock (2,500 shares)		2,500	2,227
	Total Investment		**55,307**	**55,034**
Axium Healthcare Pharmacy, Inc.	Senior Loan (14.0%, Due 12/12)	3,750	3,719	3,750
(Healthcare Services)	Unitranche Debt (14.0%, Due 12/12)	8,500	8,465	8,500
	Common Stock (22,860 shares)		2,286	800
	Total Investment		**14,470**	**13,050**
Baird Capital Partners IV Limited[5]	Limited Partnership Interest		2,630	2,492
(Private Equity Fund)	**Total Investment**		**2,630**	**2,492**
BenefitMall, Inc.	Subordinated Debt (14.9%, Due 10/13-10/14)	76,189	75,978	75,978
(Business Services)	Common Stock (39,274,290 shares)[12]		39,274	82,250
	Warrants[12]			
	Total Investment		**115,252**	**158,228**
Broadcast Electronics, Inc.	Senior Loan (8.0%, Due 7/12)[6]	4,913	4,884	2,781
(Business Services)	**Total Investment**		**4,884**	**2,781**
Bushnell, Inc.	Subordinated Debt (9.2%, Due 2/14)	41,325	39,862	38,206
(Consumer Products)	**Total Investment**		**39,862**	**38,206**
Callidus Debt Partners				

CDO Fund I, Ltd.(4)(10)	Class C Notes (12.9%, Due 12/13)	18,800	18,924	18,988
(CDO)	Class D Notes (17.0%, Due 12/13)	9,400	9,462	9,494
	Total Investment		**28,386**	**28,482**
Callidus Debt Partners				
CLO Fund III, Ltd.(4)(10)	Preferred Shares (23,600,000 shares, 15.3%) (11)		21,435	20,029
(CLO)	**Total Investment**		**21,435**	**20,029**
Callidus Debt Partners				
CLO Fund IV, Ltd.(4)(10)	Class D Notes (7.6%, Due 4/20)	3,000	1,953	2,627
(CLO)	Income Notes (18.6%)(11)		15,192	14,929
	Total Investment		**17,145**	**17,556**

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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	March 31, 2008 (unaudited) Cost	Value
Callidus Debt Partners				
CLO Fund V, Ltd.(4)(10)	Income Notes (20.3%)(11)		$ 13,838	$ 13,818
(CLO)	**Total Investment**		**13,838**	**13,818**
Callidus Debt Partners				
CLO Fund VI, Ltd.(4)(10)	Class D Notes (11.4%) Due 10/21)	$ 5,000	4,341	4,487
(CLO)	Income Notes (18.0%)(11)		28,308	26,540
	Total Investment		**32,649**	**31,027**
Callidus Debt Partners				
CLO Fund VII, Ltd.(4)(10)	Income Notes (16.6%)(11)		23,041	23,041
(CLO)	**Total Investment**		**23,041**	**23,041**
Callidus MAPS CLO Fund I LLC(10)	Class E Notes (8.1%, Due 12/17)	17,000	17,000	15,497
(CLO)	Income Notes (3.7%)(11)		48,422	31,530
	Total Investment		**65,422**	**47,027**
Callidus MAPS CLO Fund II, Ltd. (4)(10)	Income Notes (15.7%)(11)		18,755	16,741
(CLO)	**Total Investment**		**18,755**	**16,741**
Carlisle Wide Plank Floors, Inc.	Senior Loan (7.8%, Due 6/11)	500	497	496
(Consumer Products)	Unitranche Debt (10.0%, Due 6/11)	3,161	3,132	3,161
	Preferred Stock (345,056 Shares)		345	362
	Total Investment		**3,974**	**4,019**

Catterton Partners VI, L.P.[5]	Limited Partnership Interest	2,536	2,477
(Private Equity Fund)	**Total Investment**	**2,536**	**2,477**
Centre Capital Investors V, L.P.[5]	Limited Partnership Interest	720	720
(Private Equity Fund)	**Total Investment**	**720**	**720**

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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]	March 31, 2008 (unaudited) Principal	Cost	Value
CK Franchising, Inc.	Senior Loan (5.9%, Due 7/12)	$ 8,150	$ 8,066	$ 8,066
(Consumer Services)	Subordinated Debt (12.3%, Due 7/12 7/17)	21,038	20,951	20,951
	Preferred Stock (1,281,887 shares)		1,282	1,422
	Common Stock (7,585,549 shares)		7,586	7,600
	Total Investment		**37,885**	**38,039**
Commercial Credit Group, Inc.	Subordinated Debt (14.8%, Due 2/11)	12,000	12,021	12,021
(Financial Services)	Preferred Stock (64,679 shares)		15,543	9,073
	Warrants			
	Total Investment		**27,564**	**21,094**
Community Education Centers, Inc.	Subordinated Debt (13.5%, Due 11/13)	35,145	35,074	34,211
(Education Services)	**Total Investment**		**35,074**	**34,211**
Component Hardware Group, Inc.	Subordinated Debt (13.5%, Due 1/13)	18,501	18,435	18,666
(Industrial Products)	**Total Investment**		**18,435**	**18,666**
Cook Inlet Alternative Risk, LLC	Unitranche Debt (10.8%, Due 4/13)	90,000	89,552	90,954
(Business Services)	Equity Interests		552	700
	Total Investment		**90,104**	**91,654**
Cortec Group Fund IV, L.P.[5]	Limited Partnership Interest		3,470	2,998
(Private Equity)	**Total Investment**		**3,470**	**2,998**

Diversified Mercury Communications, LLC	Senior Loan (6.1%, Due 3/13)	233	218	220
(Business Services)	**Total Investment**		**218**	**220**
Digital VideoStream, LLC	Unitranche Debt (11.0%, Due 2/12)	17,257	17,177	17,528
(Business Services)	Convertible Subordinated Debt (10.0%, Due 2/16)	4,220	4,207	5,894
	Total Investment		**21,384**	**23,422**
DirectBuy Holdings, Inc.	Subordinated Debt (14.5%, Due 5/13)	75,000	74,648	72,744
(Consumer Products)	Equity Interests		8,000	5,400
	Total Investment		**82,648**	**78,144**
Distant Lands Trading Co.	Senior Loan (10.3%, Due 11/11)	9,000	8,968	8,736
(Consumer Products)	Unitranche Debt (13.0%, Due 11/11)	42,375	42,235	42,423
	Common Stock (3,451 shares)		3,451	905
	Total Investment		**54,654**	**52,064**
Driven Brands, Inc.	Senior Loan (8.2%, Due 6/11)	40,270	40,148	40,148
d/b/a Meineke and Econo Lube	Subordinated Debt (12.1%, Due 6/12 6/13)	82,960	82,715	82,715
(Consumer Services)	Common Stock (10,463,473 shares)(12)		26,398	6,079
	Warrants(12)			
	Total Investment		**149,261**	**128,942**

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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	March 31, 2008 (unaudited) Cost	Value
Dryden XVIII Leveraged Loan 2007 Limited[4]	Class B Notes (9.7%, Due 10/19)	$ 9,000	$ 7,420	$ 8,257
(CLO)	Income Notes (12.7%)[11]		22,727	19,803
	Total Investment		**30,147**	**28,060**
Dynamic India Fund IV[4][5]	Equity Interests		9,350	11,524
(Private Equity Fund)	**Total Investment**		**9,350**	**11,524**
EarthColor, Inc.	Subordinated Debt (15.0%, Due 11/13)	117,759	117,284	117,284
(Business Services)	Common Stock (63,438 shares)[12]		63,438	66,434
	Warrants[12]			
	Total Investment		**180,722**	**183,718**
eCentury Capital Partners, L.P.[5]	Limited Partnership Interest		7,274	2,076
(Private Equity Fund)	**Total Investment**		**7,274**	**2,076**
eInstruction Corporation	Subordinated Debt (12.0%, Due 7/14-1/15)	47,000	46,774	45,738
(Education Services)	Common Stock (2,406 shares)		2,500	2,700
	Total Investment		**49,274**	**48,438**
Farley s & Sathers Candy Company, Inc.	Subordinated Debt (12.7%, Due 3/11)	18,000	17,937	17,100
(Consumer Products)	**Total Investment**		**17,937**	**17,100**
FCP-BHI Holdings, LLC	Subordinated Debt (12.5%, Due 9/13)	24,939	24,831	24,241

d/b/a Bojangles	Equity Interests		863	1,400
(Retail)	**Total Investment**		**25,694**	**25,641**
Fidus Mezzanine Capital, L.P.(5)	Limited Partnership Interest		6,357	6,357
(Private Equity Fund)	**Total Investment**		**6,357**	**6,357**
Freedom Financial Network, LLC	Senior Loan (6.8%, Due 2/13)	12,968	12,968	12,968
(Financial Services)	Subordinated Debt (13.5%, Due 2/14)	13,000	12,936	12,936
	Total Investment		**25,904**	**25,904**
Frozen Specialties, Inc.	Warrants		375	
(Consumer Products)	**Total Investment**		**375**	
Garden Ridge Corporation	Subordinated Debt (7.0%, Due 5/12)(6)	20,500	20,500	20,500
(Retail)	**Total Investment**		**20,500**	**20,500**
Geotrace Technologies, Inc.	Subordinated Debt (10.0%, Due 6/09)	6,198	6,068	6,260
(Energy Services)	Warrants		2,027	2,700
	Total Investment		**8,095**	**8,960**

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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]**	**March 31, 2008 (unaudited)** Principal	Cost	Value
Gilchrist & Soames, Inc.	Senior Loan (8.4%, Due 10/13)	$ 5,000	$ 4,956	$ 4,756
(Consumer Products)	Subordinated Debt (13.4%, Due 10/13)	25,800	25,682	25,342
	Total Investment		**30,638**	**30,098**
Havco Wood Products LLC	Unitranche Debt (11.5%, Due 8/11)	5,100	4,293	5,208
(Industrial Products)	Equity Interests		910	2,900
	Total Investment		**5,203**	**8,108**
Haven Eldercare of New England, LLC	Subordinated Debt (12.0%, Due 8/09)[6]	1,439	1,439	
(Healthcare Services)	**Total Investment**		**1,439**	
Higginbotham Insurance Agency, Inc.	Senior Loan (7.2%, Due 8/12)	17,546	17,459	17,459
(Business Services)	Subordinated Debt (13.6%, Due 8/13 8/14)	46,883	46,669	46,669
	Common Stock (22,020 shares)[12]		22,020	22,887
	Warrant[12]			
	Total Investment		**86,148**	**87,015**
The Hillman Companies, Inc.[3]	Subordinated Debt (10.0%, Due 9/11)	44,580	44,466	44,580
(Consumer Products)	**Total Investment**		**44,466**	**44,580**
The Homax Group, Inc.	Senior Loan (8.7%, Due 10/12)	10,940	10,940	10,508
(Consumer Products)	Subordinated Debt (12.0%, Due 4/14)	14,000	13,283	13,571
	Preferred Stock (76 shares)		76	5
	Common Stock (24 shares)		5	
	Warrants		954	80

	Total Investment		**25,258**	**24,164**
Ideal Snacks Corporation	Senior Loan (7.0%, Due 6/10)	545	545	535
(Consumer Products)	**Total Investment**		**545**	**535**
Integrity Interactive Corporation	Unitranche Debt (10.5%, Due 2/12)	11,952	11,860	12,175
(Business Services)	**Total Investment**		**11,860**	**12,175**
International Fiber Corporation	Subordinated Debt (14.0%, Due 6/12)	24,697	24,607	25,438
(Industrial Products)	Preferred Stock (21,566 shares)		2,157	2,157
	Total Investment		**26,764**	**27,595**

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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)]	March 31, 2008 (unaudited) Principal	Cost	Value
Jones Stephens Corporation	Senior Loan (7.5%, Due 9/12)	$ 5,516	$ 5,505	$ 5,272
(Consumer Products)	**Total Investment**		**5,505**	**5,272**
Knightsbridge CLO 2007-1 Limited[(4)]	Class E Notes (14.1%, Due 1/22)	22,000	22,000	21,983
(CLO)	Income Notes (18.5%)[(11)]		32,413	30,985
	Total Investment		**54,413**	**52,968**
Kodiak Fund LP[(5)]	Equity Interests		9,423	2,835
(Private Equity Fund)	**Total Investment**		**9,423**	**2,835**
Line-X, Inc.	Senior Loan (15.0%, Due 8/11)	900	886	886
(Consumer Products)	Unitranche Debt (15.0% Due 8/11)	48,204	48,055	42,810
	Total Investment		**48,941**	**43,696**
	Standby Letter of Credit ($1,500)			
MedAssets, Inc.[(3)]	Common Stock (224,817 shares)		2,289	3,332
(Business Services)	**Total Investment**		**2,289**	**3,332**
Milestone AV Technologies, Inc.	Subordinated Debt (9.2%, Due 6/13)	37,500	37,500	37,500
(Business Services)	**Total Investment**		**37,500**	**37,500**
NetShape Technologies, Inc.	Senior Loan (6.5%, Due 2/13)	5,820	5,792	5,282
(Industrial Products)	**Total Investment**		**5,792**	**5,282**

Network Hardware Resale, Inc.	Unitranche Debt (10.5%, Due 12/11)	20,219	20,314	20,624
(Business Services)	Convertible Subordinated Debt (9.8%, Due 12/15)	14,533	14,591	16,560
	Total Investment		**34,905**	**37,184**
Norwesco, Inc.	Subordinated Debt (12.4%, Due 1/12 7/12)	61,866	61,558	61,558
(Industrial Products)	Common Stock (482,736 shares)(12)		3,676	64,854
	Warrants(12)			
	Total Investment		**65,234**	**126,412**
Novak Biddle Venture Partners III, L.P.(5)	Limited Partnership Interest		1,910	1,496
(Private Equity Fund)	**Total Investment**		**1,910**	**1,496**

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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]	March 31, 2008 (unaudited) Principal	Cost	Value
Oahu Waste Services, Inc.	Stock Appreciation Rights		$ 206	$ 1,000
(Business Services)	**Total Investment**		**206**	**1,000**
Pangaea CLO 2007-1 Ltd.[4]	Class D Notes (8.7%, Due 10/21)	$ 15,000	11,594	10,760
(CLO)	**Total Investment**		**11,594**	**10,760**
Passport Health Communications, Inc.	Preferred Stock (561,908 shares)		1,725	2,207
(Healthcare Services)	Common Stock (16,977 shares)		42	54
	Total Investment		**1,767**	**2,261**
PC Helps Support, LLC	Senior Loan (6.6%, Due 12/13)	19,214	19,206	18,732
(Business Services)	Subordinated Debt (13.3%, Due 12/13)	29,681	29,535	29,196
	Total Investment		**48,741**	**47,928**
Pendum, Inc.	Subordinated Debt (17.0%, Due 1/11)[6]	34,028	34,028	
(Business Services)	Preferred Stock (82,715 shares)			
	Warrants			
	Total Investment		**34,028**	
Performant Financial Corporation	Common Stock (478,816 shares)		734	
(Business Services)	**Total Investment**		**734**	
Peter Brasseler Holdings, LLC	Equity Interests		2,500	2,279
(Business Services)	**Total Investment**		**2,500**	**2,279**

PharMEDium Healthcare Corporation	Senior Loan (6.6%, Due 10/13)	20,042	20,042	19,356
(Healthcare Services)	**Total Investment**		**20,042**	**19,356**
Postle Aluminum Company, LLC	Unitranche Debt (11.0%, Due 10/12)	61,250	61,015	60,104
(Industrial Products)	Equity Interests		2,157	2,202
	Total Investment		**63,172**	**62,306**

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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]	March 31, 2008 (unaudited) Principal	Cost	Value
Pro Mach, Inc.	Subordinated Debt (13.0%, Due 6/12)	$ 14,598	$ 14,545	$ 14,781
(Industrial Products)	Equity Interests		1,294	1,600
	Total Investment		**15,839**	**16,381**
Promo Works, LLC	Unitranche Debt (10.3%, Due 12/11)	25,899	25,702	25,985
(Business Services)	**Total Investment**		**25,702**	**25,985**
	Guaranty ($300)			
Reed Group, Ltd.	Senior Loan (8.5%, Due 12/13)	21,000	20,970	20,044
(Healthcare Services)	Subordinated Debt (13.8%, Due 12/13)	18,000	17,914	17,258
	Equity Interests		1,800	900
	Total Investment		**40,684**	**38,202**
S.B. Restaurant Company	Unitranche Debt (9.8%, Due 4/11)	38,501	38,232	38,127
(Retail)	Preferred Stock (46,690 shares)		117	117
	Warrants		534	1,000
	Total Investment		**38,883**	**39,244**
	Standby Letters of Credit ($2,540)			
Service Center Metals, LLC	Subordinated Debt (15.5%, Due 9/11)	5,000	4,982	4,948
(Industrial Products)	Equity Interests		270	302
	Total Investment		**5,252**	**5,250**
Snow Phipps Group, L.P.[5]	Limited Partnership Interest		2,329	2,329
(Private Equity Fund)	**Total Investment**		**2,329**	**2,329**

SPP Mezzanine Funding II, L.P.[5]	Limited Partnership Interest		5,223	4,897
(Private Equity Fund)	**Total Investment**		**5,223**	**4,897**
Stag-Parkway, Inc.	Unitranche Debt (10.8%, Due 7/12)	50,096	49,916	50,096
(Business Services)	**Total Investment**		**49,916**	**50,096**
STS Operating, Inc.	Subordinated Debt (11.0%, Due 1/13)	30,386	30,279	30,994
(Industrial Products)	**Total Investment**		**30,279**	**30,994**
Summit Energy Services, Inc.	Senior Loan (8.0%, Due 8/13)	9,179	9,179	8,903
(Business Services)	Subordinated Debt (11.6%, Due 8/13)	35,765	35,603	36,029
	Common Stock (385,626 shares)		1,725	1,600
	Total Investment		**46,507**	**46,532**

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

(5) Non-registered investment company.

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

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

		March 31, 2008 (unaudited)		
Private Finance Portfolio Company (in thousands, except number of shares)	**Investment[1][2]**	**Principal**	**Cost**	**Value**
Tappan Wire and Cable Inc.	Unitranche Debt (15.0%, Due 8/14)	$ 22,346	$ 22,235	$ 22,235
(Business Services)	Common Stock (12,940 shares)[12]		1,941	6,201
	Warrant[12]			
	Total Investment		**24,176**	**28,436**
The Step2 Company, LLC	Unitranche Debt (11.0%, Due 4/12)	95,801	95,473	96,465
(Consumer Products)	Equity Interests		2,142	2,419
	Total Investment		**97,615**	**98,884**
Tradesmen International, Inc.	Subordinated Debt (12.0%, Due 12/12)	49,124	48,489	47,820
(Business Services)	**Total Investment**		**48,489**	**47,820**
TransAmerican Auto Parts, LLC	Subordinated Debt (14.0%, Due 11/12)	24,195	24,035	23,235
(Consumer Products)	Equity Interests		1,034	576
	Total Investment		**25,069**	**23,811**
Triax Holdings, LLC	Subordinated Debt (19.0%, Due 2/12)	10,193	10,150	10,334
(Consumer Products)	Equity Interests		16,528	41,093
	Total Investment		**26,678**	**51,427**
Trover Solutions, Inc.	Subordinated Debt (12.0%, Due 11/12)	60,230	59,983	59,987
(Business Services)	**Total Investment**		**59,983**	**59,987**

Universal Air Filter Company	Subordinated Debt (12.0%, Due 11/12)	14,625	14,566	14,728
(Industrial Products)	**Total Investment**		**14,566**	**14,728**
United Road Towing, Inc.	Subordinated Debt (10.4%, Due 1/14)	44,000	43,787	43,787
(Consumer Services)	**Total Investment**		**43,787**	**43,787**
Venturehouse-Cibernet Investors, LLC	Equity Interest			
(Business Services)	**Total Investment**			
VICORP Restaurants, Inc.	Warrants		33	
(Retail)	**Total Investment**		**33**	
Walker Investment Fund II, LLLP(5)	Limited Partnership Interest		1,330	333
(Private Equity Fund)	**Total Investment**		**1,330**	**333**
WMA Equity Corporation and Affiliates	Subordinated Debt (14.0%, Due 4/13)	125,323	124,380	121,395
d/b/a Wear Me Apparel	Subordinated Debt (9.0%, Due 4/14)(6)	11,151	11,151	11,749
(Consumer Products)	Common Stock (86 shares)		39,721	5,349
	Total Investment		**175,252**	**138,493**

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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.

(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]	March 31, 2008 (unaudited) Principal	Cost	Value
Webster Capital II, L.P.(5)	Limited Partnership Interest		$ 897	$ 897
(Private Equity Fund)	**Total Investment**		**897**	**897**
Woodstream Corporation	Subordinated Debt (12.0%, Due 2/15)	$ 90,000	89,588	85,374
(Consumer Products)	Common Stock (6,470 shares)		6,470	4,200
	Total Investment		**96,058**	**89,574**
York Insurance Services Group, Inc.	Subordinated Debt (14.5%, Due 1/14)	45,367	45,199	45,236
(Business Services)	Common Stock (12,939 shares)		1,294	1,600
	Total Investment		**46,493**	**46,836**
Other companies	Other debt investments	3,236	3,142	3,169
	Other equity investments		8	
	Total Investment		**3,150**	**3,169**
Total companies less than 5% owned			**$ 3,001,894**	**$ 2,980,548**
Total private finance (152 portfolio investments)			**$ 5,019,313**	**$ 4,519,779**

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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	March 31, 2008 (unaudited) Cost	Value
Commercial Mortgage Loans				
	Up to 6.99%	1	$ 13,702	$ 13,702
	7.00% 8.99%	7	17,411	16,763
	9.00% 10.99%	1	6,455	6,455
	11.00% 12.99%	1	10,459	10,459
	15.00% and above	2	3,970	6,109
Total commercial mortgage loans(13)			$ 51,997	$ 53,488
Real Estate Owned			$ 23,531	$ 30,220
Equity Interests(2) Companies more than 25% owned			$ 14,179	$ 32,146
Guarantees ($6,871)				
Standby Letter of Credit ($1,295)				
Total commercial real estate finance			$ 89,707	$ 115,854
Total portfolio			$ 5,109,020	$ 4,635,633

	Yield	Cost	Value
Investments in U.S. Treasury Bills, Money Market and Other Securities			
U.S. Treasury bills (Due April 2008)	1.6%	$ 119,842	$ 119,976
Blackrock Liquidity Funds	3.3%	344	344
SEI Daily Income Tr Prime Obligation Money Market Fund	3.1%	59	59
American Beacon Money Market Fund	3.1%	20	20
Columbia Treasury Reserves Money Market Fund	3.2%	7	7
Total		$ 120,272	$ 120,406

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

(13) Commercial mortgage loans totaling $7.4 million at value were on non-accrual status and therefore were considered non-income producing.

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF INVESTMENTS

Private Finance Portfolio Company (in thousands, except number of shares)	Investment[(1)(2)]	December 31, 2007 Principal	Cost	Value
Companies More Than 25% Owned				
Alaris Consulting, LLC	Senior Loan (16.5%, Due 12/05 12/07)[(6)]	$ 27,055	$ 26,987	$
(Business Services)	Equity Interests		5,189	
	Total Investment		**32,176**	
	Guaranty ($1,100)			
AllBridge Financial, LLC	Equity Interests		7,800	7,800
(Asset Management)	**Total Investment**		**7,800**	**7,800**
	Standby Letter of Credit ($30,000)			
Allied Capital Senior Debt Fund, L.P. [(5)]	Equity Interests (See Note 3)		31,800	32,811
(Private Debt Fund)	**Total Investment**		**31,800**	**32,811**
Avborne, Inc.[(7)]	Preferred Stock (12,500 shares)		611	1,633
(Business Services)	Common Stock (27,500 shares)			
	Total Investment		**611**	**1,633**
Avborne Heavy Maintenance, Inc.[(7)]	Preferred Stock (1,568 shares)		2,401	2,557
(Business Services)	Common Stock (2,750 shares)			370
	Total Investment		**2,401**	**2,927**
	Guaranty ($2,401)			
Aviation Properties Corporation	Common Stock (100 shares)		65	
(Business Services)	**Total Investment**		**65**	
	Standby Letters of Credit ($1,000)			

Border Foods, Inc.	Preferred Stock (100,000 shares)		12,721	4,648
(Consumer Products)	Common Stock (148,838 shares)		3,847	
	Total Investment		**16,568**	**4,648**
Calder Capital Partners, LLC[5]	Senior Loan (9.4%, Due 5/09)[6]	2,907	2,907	3,035
(Asset Management)	Equity Interests		2,396	3,559
	Total Investment		**5,303**	**6,594**
Callidus Capital Corporation	Subordinated Debt (18.0%, Due 10/08)	6,871	6,871	6,871
(Asset Management)	Common Stock (100 shares)		2,067	44,587
	Total Investment		**8,938**	**51,458**
Ciena Capital LLC	Class A Equity Interests(25.0% See Note 3) [6]	99,044	99,044	68,609
(Financial Services)	Class B Equity Interests		119,436	
	Class C Equity Interests		109,301	
	Total Investment		**327,781**	**68,609**
	Guaranty ($258,707 See Note 3)			
	Standby Letters of Credit ($18,000 See Note 3)			

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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)	December 31, 2007 Principal	Cost	Value
CitiPostal Inc.	Senior Loan (8.4%, Due 12/13)	$ 692	$ 679	$ 679
(Business Services)	Unitranche Debt (12.0%, Due 12/13)	50,852	50,597	50,597
	Subordinated Debt (16.0%, Due 12/15)	8,049	8,049	8,049
	Common Stock (37,024 shares)		12,726	12,726
	Total Investment		**72,051**	**72,051**
Coverall North America, Inc.	Unitranche Debt (12.0%, Due 7/11)	35,054	34,923	34,923
(Business Services)	Subordinated Debt (15.0%, Due 7/11)	6,000	5,979	5,979
	Common Stock (884,880 shares)		16,648	27,597
	Total Investment		**57,550**	**68,499**
CR Holding, Inc.	Subordinated Debt (16.6%, Due 2/13)	40,956	40,812	40,812
(Consumer Products)	Common Stock (37,200,551 shares)		33,321	40,934
	Total Investment		**74,133**	**81,746**
Direct Capital Corporation	Subordinated Debt (16.0%, Due 3/13)	39,184	39,030	39,030
(Financial Services)	Common Stock (2,097,234 shares)		19,250	6,906
	Total Investment		**58,280**	**45,936**
Financial Pacific Company	Subordinated Debt (17.4%, Due 2/12 8/12)	73,031	72,850	72,850
(Financial Services)	Preferred Stock (10,964 shares)		10,276	19,330
	Common Stock (14,735 shares)		14,819	38,544
	Total Investment		**97,945**	**130,724**
ForeSite Towers, LLC	Equity Interest			878

(Tower Leasing)				
	Total Investment			**878**
Global Communications, LLC	Senior Loan (10.0%, Due 9/02)[6]	1,822	1,822	1,822
(Business Services)	**Total Investment**		**1,822**	**1,822**
Hot Stuff Foods, LLC	Senior Loan (8.4%, Due 2/11-2/12)	50,940	50,752	50,752
(Consumer Products)	Subordinated Debt (12.1%, Due 8/12)	30,000	29,907	29,907
	Subordinated Debt (15.4%, Due 2/13)[6]	52,373	52,150	1,337
	Common Stock (1,147,453 shares)		56,187	
	Total Investment		**188,996**	**81,996**
Huddle House, Inc.	Subordinated Debt (15.0%, Due 12/12)	59,857	59,618	59,618
(Retail)	Common Stock (415,328 shares)		41,533	44,154
	Total Investment		**101,151**	**103,772**
Impact Innovations Group, LLC	Equity Interests in Affiliate			320
(Business Services)	**Total Investment**			**320**

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(2) Common stock, preferred stock, warrants, options, and equity interests are generally non-income producing and restricted.
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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, 2007 Principal	Cost	Value
Insight Pharmaceuticals Corporation	Subordinated Debt (15.0%, Due 9/12)	$ 44,257	$ 44,136	$ 45,041
(Consumer Products)	Subordinated Debt (19.0%, Due 9/12)[6]	16,181	16,130	16,796
	Preferred Stock (25,000 shares)		25,000	1,462
	Common Stock (620,000 shares)		6,325	
	Total Investment		**91,591**	**63,299**
Jakel, Inc.	Subordinated Debt (15.5%, Due 3/08)[6]	1,563	1,563	1,563
(Industrial Products)	**Total Investment**		**1,563**	**1,563**
Legacy Partners Group, Inc.	Senior Loan (14.0%, Due 5/09)[6]	3,843	3,843	3,843
(Business Services)	Equity Interests		4,261	1,332
	Total Investment		**8,104**	**5,175**
Litterer Beteiligungs-GmbH[4]	Subordinated Debt (8.0%, Due 12/08)	772	772	772
(Business Services)	Equity Interest		1,809	700
	Total Investment		**2,581**	**1,472**
MVL Group, Inc.	Senior Loan (12.0%, Due 6/09 7/09)	30,674	30,639	30,639
(Business Services)	Subordinated Debt (14.5%, Due 6/09 7/09)	40,191	39,943	39,943
	Common Stock (648,661 shares)		643	4,949
	Total Investment		**71,225**	**75,531**
Old Orchard Brands, LLC	Subordinated Debt (18.0%, Due 7/14)	19,632	19,544	19,544
(Consumer Products)	Equity Interests		18,767	25,419
	Total Investment		**38,311**	**44,963**

Penn Detroit Diesel Allison, LLC	Subordinated Debt (15.5%, Due 8/13)	39,331	39,180	39,180
(Business Services)	Equity Interests		21,128	37,965
	Total Investment		**60,308**	**77,145**
Powell Plant Farms, Inc.	Senior Loan (15.0%, Due 12/07)[6]	1,350	1,350	1,534
(Consumer Products)	**Total Investment**		**1,350**	**1,534**
Service Champ, Inc.	Subordinated Debt (15.5%, Due 4/12)	28,443	28,351	28,351
(Business Services)	Common Stock (63,888 shares)		13,662	26,292
	Total Investment		**42,013**	**54,643**
Staffing Partners Holding Company, Inc.	Subordinated Debt (13.5%, Due 1/07)[6]	509	509	223
(Business Services)	**Total Investment**		**509**	**223**
Startec Equity, LLC	Equity Interests		190	430
(Telecommunications)	**Total Investment**		**190**	**430**
Sweet Traditions, Inc.	Senior Loan (13.0%, Due 9/08 8/11)[6]	39,692	36,052	35,229
(Retail)	Preferred Stock (961 shares)		950	
	Common Stock (10,000 shares)		50	
	Total Investment		**37,052**	**35,229**

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

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

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

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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, 2007 Principal	Cost	Value
Triview Investments, Inc.[8]	Senior Loan (10.0%, Due 12/07)	$ 433	$ 433	$ 433
(Broadcasting & Cable/Business	Subordinated Debt (12.9%, Due 1/10 6/17)	43,157	42,977	42,977
Services/Consumer Products)	Subordinated Debt (12.5%, Due 11/07 3/08)[6]	1,400	1,400	1,583
	Common Stock (202 shares)		120,638	83,453
	Total Investment		**165,448**	**128,446**
	Guaranty ($900)			
	Standby Letter of Credit ($200)			
Unitranche Fund LLC	Subordinated Certificates		744	744
(Private Debt Fund)	Equity Interests		1	1
	Total Investment		**745**	**745**
Worldwide Express Operations, LLC	Subordinated Debt (14.0%, Due 2/14)	2,845	2,670	2,670
(Business Services)	Equity Interests		12,900	21,516
	Warrants		163	272
	Total Investment		**15,733**	**24,458**
Total companies more than 25% owned			**$ 1,622,094**	**$ 1,279,080**
Companies 5% to 25% Owned				
10th Street, LLC	Subordinated Debt (13.0%, Due 12/14)	$ 20,774	$ 20,645	$ 20,645
(Business Services)	Equity Interests		446	1,100
	Total Investment		**21,091**	**21,745**
Advantage Sales & Marketing, Inc.		155,432	154,854	154,854

	Subordinated Debt (12.0%, Due 3/14)			
(Business Services)	Equity Interests			10,973
	Total Investment		**154,854**	**165,827**
Air Medical Group Holdings LLC	Senior Loan (7.8%, Due 3/11)	3,030	2,980	2,980
(Healthcare Services)	Equity Interests		3,470	10,800
	Total Investment		**6,450**	**13,780**
Alpine ESP Holdings, Inc.	Preferred Stock (622 shares)		622	749
(Business Services)	Common Stock (13,513 shares)		14	262
	Total Investment		**636**	**1,011**
Amerex Group, LLC	Subordinated Debt (12.0%, Due 1/13)	8,400	8,400	8,400
(Consumer Products)	Equity Interests		3,509	13,713
	Total Investment		**11,909**	**22,113**
BB&T Capital Partners/Windsor Mezzanine Fund, LLC[5]	Equity Interests		11,739	11,467
(Private Equity Fund)	**Total Investment**		**11,739**	**11,467**

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(8) Triview Investments, Inc. had a cost basis of $165.4 million and holds investments in Longview Cable & Data, LLC (Broadcasting & Cable) with a value of $7.0 million, Triax Holdings, LLC (Consumer Products) with a value of $62.0 million, and Crescent Hotels & Resorts, LLC and affiliates (Business Services) with a value of $59.4 million, for a total value of $128.4 million.

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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, 2007 Principal	Cost	Value
Becker Underwood, Inc.	Subordinated Debt (14.5%, Due 8/12)	$ 24,865	$ 24,798	$ 24,798
(Industrial Products)	Common Stock (5,073 shares)		5,813	4,190
	Total Investment		**30,611**	**28,988**
BI Incorporated	Subordinated Debt (13.5%, Due 2/14)	30,615	30,499	30,499
(Business Services)	Common Stock (40,000 shares)		4,000	7,382
	Total Investment		**34,499**	**37,881**
Creative Group, Inc.	Subordinated Debt (14.0%, Due 9/13)[6]	15,000	13,686	6,197
(Business Services)	Common Stock (20,000 shares)			
	Warrant		1,387	
	Total Investment		**15,073**	**6,197**
Drew Foam Companies, Inc.	Preferred Stock (722 shares)		722	396
(Business Services)	Common Stock (7,287 shares)		7	
	Total Investment		**729**	**396**
MedBridge Healthcare, LLC	Senior Loan (8.0%, Due 8/09)[6]	7,164	7,164	7,164
(Healthcare Services)	Subordinated Debt (10.0%, Due 8/14)[6]	5,184	5,184	2,406
	Convertible Subordinated Debt (2.0%, Due 8/14) [6]	2,970	984	
	Equity Interests		1,416	
	Total Investment		**14,748**	**9,570**
MHF Logistical Solutions, Inc.	Subordinated Debt (11.5%, Due 6/12)[6]	33,600	33,448	9,280
(Business Services)	Subordinated Debt (18.0%, Due 6/13)[6]	11,211	11,154	

	Common Stock (20,934 shares)(12)		20,942	
	Warrants(12)			
	Total Investment		**65,544**	**9,280**
Multi-Ad Services, Inc.	Unitranche Debt (11.3%, Due 11/11)	19,800	19,704	19,704
(Business Services)	Equity Interests		2,000	940
	Total Investment		**21,704**	**20,644**
Progressive International Corporation	Subordinated Debt (16.0%, Due 12/09)	1,557	1,545	1,545
(Consumer Products)	Preferred Stock (500 shares)		500	1,038
	Common Stock (197 shares)		13	4,900
	Warrants			
	Total Investment		**2,058**	**7,483**
Regency Healthcare Group, LLC	Unitranche Debt (11.1%, Due 6/12)	12,000	11,941	11,941
(Healthcare Services)	Equity Interests		1,500	1,681
	Total Investment		**13,441**	**13,622**

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(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.

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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, 2007 Principal	Cost	Value
SGT India Private Limited[4]	Common Stock (150,596 shares)		$ 4,098	$ 3,075
(Business Services)	**Total Investment**		**4,098**	**3,075**
Soteria Imaging Services, LLC	Subordinated Debt (12.0%, Due 11/10)	$ 14,500	13,744	13,744
(Healthcare Services)	Equity Interests		2,170	2,686
	Total Investment		**15,914**	**16,430**
Universal Environmental Services, LLC	Equity Interests		1,810	
(Business Services)	**Total Investment**		**1,810**	
Total companies 5% to 25% owned			**$ 426,908**	**$ 389,509**
Companies Less Than 5% Owned				
3SI Security Systems, Inc.	Subordinated Debt (14.5%, Due 8/13)	$ 27,937	$ 27,837	$ 27,837
(Consumer Products)	**Total Investment**		**27,837**	**27,837**
AgData, L.P.	Senior Loan (10.3%, Due 7/12)	843	815	815
(Consumer Services)	**Total Investment**		**815**	**815**
Axium Healthcare Pharmacy, Inc.	Senior Loan (12.5%, Due 12/12)	2,600	2,567	2,567
(Healthcare Services)	Unitranche Debt (12.5%, Due 12/12)	8,500	8,463	8,463
	Common Stock (26,500 shares)		2,650	1,097
	Total Investment		**13,680**	**12,127**
Baird Capital Partners IV Limited Partnership[5]	Limited Partnership Interest		2,234	2,114

(Private Equity Fund)	**Total Investment**		**2,234**	**2,114**
BenefitMall, Inc.	Subordinated Debt (14.9%, Due 10/13 10/14)	82,167	81,930	81,930
(Business Services)	Common Stock (45,528,000 shares)[12]		45,528	82,404
	Warrants[12]			
	Standby Letters of Credit ($3,961)			
	Total Investment		**127,458**	**164,334**
Broadcast Electronics, Inc.	Senior Loan (9.0%, Due 7/12)[6]	4,913	4,884	3,273
(Business Services)	**Total Investment**		**4,884**	**3,273**
Bushnell, Inc.	Subordinated Debt (11.3%, Due 2/14)	41,325	39,821	39,821
(Consumer Products)	**Total Investment**		**39,821**	**39,821**

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(2) Common stock, preferred stock, warrants, options, and equity interests are generally non-income producing and restricted.
(4) Non-U.S. company or principal place of business outside the U.S.
(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)

Private Finance Portfolio Company (in thousands, except number of shares)	Investment[1][2]	December 31, 2007 Principal	Cost	Value
Callidus Debt Partners CDO Fund I, Ltd.[4][10]	Class C Notes (12.9%, Due 12/13)	$ 18,800	$ 18,929	$ 18,988
(CDO)	Class D Notes (17.0%, Due 12/13)	9,400	9,465	9,494
	Total Investment		**28,394**	**28,482**
Callidus Debt Partners CLO Fund III, Ltd.[4][10]	Preferred Shares (23,600,000 shares, 12.9%)[11]		21,783	19,999
(CLO)	**Total Investment**		**21,783**	**19,999**
Callidus Debt Partners CLO Fund IV, Ltd.[4][10]	Income Notes (14.8%)[11]		12,298	11,290
(CLO)	**Total Investment**		**12,298**	**11,290**
Callidus Debt Partners CLO Fund V, Ltd.[4][10]	Income Notes (20.3%)[11]		13,977	14,658
(CLO)	**Total Investment**		**13,977**	**14,658**
Callidus Debt Partners CLO Fund VI, Ltd.[4][10]	Class D Notes (11.3%, Due 10/21)	5,000	4,329	4,329
(CLO)	Income Notes (19.3%)[11]		26,985	26,985
	Total Investment		**31,314**	**31,314**
Callidus Debt Partners[4][10] CLO Fund VII, Ltd.	Income Notes (16.6%)[11]		22,113	22,113
(CLO)	**Total Investment**		**22,113**	**22,113**
Callidus MAPS CLO Fund I LLC[10]	Class E Notes (10.4%, Due 12/17)	17,000	17,000	16,119

(CLO)	Income Notes (5.6%)[11]		49,252	36,085
	Total Investment		**66,252**	**52,204**
Callidus MAPS CLO Fund II, Ltd.[4][10]	Income Notes (14.7%)[11]		18,753	18,753
(CLO)	**Total Investment**		**18,753**	**18,753**
Camden Partners Strategic Fund II, L.P.[5]	Limited Partnership Interest		997	1,350
(Private Equity Fund)	**Total Investment**		**997**	**1,350**
Carlisle Wide Plank Floors, Inc.	Senior Loan (9.8%, Due 6/11)	500	497	497
(Consumer Products)	Unitranche Debt (10.0%, Due 6/11)	3,161	3,129	3,129
	Preferred Stock (400,000 Shares)		400	507
	Total Investment		**4,026**	**4,133**
Catterton Partners V, L.P.[5]	Limited Partnership Interest		3,624	2,952
(Private Equity Fund)	**Total Investment**		**3,624**	**2,952**

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(2) Common stock, preferred stock, warrants, options, and equity interests are generally non-income producing and restricted.
(4) Non-U.S. company or principal place of business outside the U.S.
(5) Non-registered investment company.
(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 from companies less than 5% owned 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)]	December 31, 2007 Principal	Cost	Value
Catterton Partners VI, L.P.[(5)]	Limited Partnership Interest		$ 2,259	$ 2,103
(Private Equity Fund)	**Total Investment**		**2,259**	**2,103**
Centre Capital Investors IV, L.P.[(5)]	Limited Partnership Interest		2,215	2,276
(Private Equity Fund)	**Total Investment**		**2,215**	**2,276**
Centre Capital Investors V, L.P.[(5)]	Limited Partnership Interest		628	628
(Private Equity Fund)	**Total Investment**		**628**	**628**
CK Franchising, Inc.	Senior Loan (8.7%, Due 7/12)	$ 9,000	8,911	8,911
(Consumer Services)	Subordinated Debt (12.3%, Due 7/12 7/17)	21,000	20,908	20,908
	Preferred Stock (1,486,004 shares)		1,486	1,586
	Common Stock (8,793,408 shares)		8,793	8,654
	Total Investment		**40,098**	**40,059**
Commercial Credit Group, Inc.	Subordinated Debt (14.8%, Due 2/11)	12,000	12,023	12,023
(Financial Services)	Preferred Stock (74,978 shares)		18,018	19,421
	Warrants			
	Total Investment		**30,041**	**31,444**
Community Education Centers, Inc.	Subordinated Debt (13.5%, Due 11/13)	35,011	34,936	34,936
(Education Services)	**Total Investment**		**34,936**	**34,936**
Component Hardware Group, Inc.	Subordinated Debt (13.5%, Due 1/13)	18,432	18,363	18,363
(Industrial Products)	**Total Investment**		**18,363**	**18,363**

Cook Inlet Alternative Risk, LLC	Unitranche Debt (10.8%, Due 4/13)	95,000	94,530	94,530
(Business Services)	Equity Interests		640	1,696
	Total Investment		**95,170**	**96,226**
Cortec Group Fund IV, L.P.[5]	Limited Partnership Interest		3,383	2,922
(Private Equity)	**Total Investment**		**3,383**	**2,922**
Diversified Mercury Communications, LLC	Senior Loan (8.5%, Due 3/13)	233	217	217
(Business Services)	**Total Investment**		**217**	**217**
Digital VideoStream, LLC	Unitranche Debt (11.0%, Due 2/12)	17,213	17,128	17,128
(Business Services)	Convertible Subordinated Debt (10.0%, Due 2/16)	4,118	4,103	5,397
	Total Investment		**21,231**	**22,525**
DirectBuy Holdings, Inc.	Subordinated Debt (14.5%, Due 5/13)	75,000	74,631	74,631
(Consumer Products)	Equity Interests		8,000	8,000
	Total Investment		**82,631**	**82,631**

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(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, 2007 Principal	Cost	Value
Distant Lands Trading Co.	Senior Loan (10.3%, Due 11/11)	$ 10,000	$ 9,966	$ $9,966
(Consumer Products)	Unitranche Debt (11.0%, Due 11/11)	42,375	42,226	42,226
	Common Stock (4,000 shares)		4,000	2,645
	Total Investment		**56,192**	**54,837**
Driven Brands, Inc.	Senior Loan (8.7%, Due 6/11)	37,070	36,951	36,951
d/b/a Meineke and Econo Lube	Subordinated Debt (12.1%, Due 6/12 6/13)	83,000	82,754	82,754
(Consumer Services)	Common Stock (11,675,331 shares)[(12)]		29,455	15,977
	Warrants[(12)]			
	Total Investment		**149,160**	**135,682**
Dryden XVIII Leveraged Loan 2007 Limited[(4)]	Subordinated Debt (9.7%, Due 10/19)	9,000	7,406	7,406
(CLO)	Income Notes (14.2%)[(11)]		21,940	21,940
	Total Investment		**29,346**	**29,346**
Dynamic India Fund IV[(4)(5)]	Equity Interests		6,050	6,215
(Private Equity Fund)	**Total Investment**		**6,050**	**6,215**
EarthColor, Inc.	Subordinated Debt (15.0%, Due 11/13)	127,000	126,463	126,463
(Business Services)	Common Stock (73,540 shares)[(12)]		73,540	62,675
	Warrants[(12)]			
	Total Investment		**200,003**	**189,138**
eCentury Capital Partners, L.P.[(5)]	Limited Partnership Interest		6,899	2,176
(Private Equity Fund)	**Total Investment**		**6,899**	**2,176**

eInstruction Corporation	Subordinated Debt (13.5%, Due 7/14 1/15)	47,000	46,765	46,765
(Education Services)	Common Stock (2,406 shares)		2,500	2,500
	Total Investment		**49,265**	**49,265**
Farley s & Sathers Candy Company, Inc.	Subordinated Debt (13.7%, Due 3/11)	18,000	17,932	17,932
(Consumer Products)	**Total Investment**		**17,932**	**17,932**
FCP-BHI Holdings, LLC	Subordinated Debt (12.8%, Due 9/13)	24,000	23,887	23,887
d/b/a Bojangles	Equity Interests		1,000	998
(Retail)	**Total Investment**		**24,887**	**24,885**
Fidus Mezzanine Capital, L.P.(5)	Limited Partnership Interest		6,357	6,357
(Private Equity Fund)	**Total Investment**		**6,357**	**6,357**
Frozen Specialties, Inc.	Warrants		435	229
(Consumer Products)	**Total Investment**		**435**	**229**
Garden Ridge Corporation	Subordinated Debt (7.0%, Due 5/12)(6)	20,500	20,500	20,500
(Retail)	**Total Investment**		**20,500**	**20,500**

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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, 2007 Principal	Cost	Value
Geotrace Technologies, Inc.	Subordinated Debt (10.0%, Due 6/09)	$ 6,772	$ 6,616	$ 6,616
(Energy Services)	Warrants		2,350	2,993
	Total Investment		**8,966**	**9,609**
Gilchrist & Soames, Inc.	Senior Loan (9.0%, Due 10/13)	20,000	19,954	19,954
(Consumer Products)	Subordinated Debt (13.4%, Due 10/13)	25,800	25,676	25,676
	Total Investment		**45,630**	**45,630**
Grotech Partners, VI, L.P.[5]	Limited Partnership Interest		8,808	8,252
(Private Equity Fund)	**Total Investment**		**8,808**	**8,252**
Havco Wood Products LLC	Senior Loan (9.7%, Due 8/11)	600	585	585
(Industrial Products)	Unitranche Debt (11.5%, Due 8/11)	5,100	4,248	4,248
	Equity Interests		1,055	3,192
	Total Investment		**5,888**	**8,025**
Haven Eldercare of New England, LLC	Subordinated Debt (12.0%, Due 8/09)[6]	1,927	1,927	
(Healthcare Services)	**Total Investment**		**1,927**	
Higginbotham Insurance Agency, Inc.	Senior Loan (7.7%, Due 8/12)	15,033	14,942	14,942
(Business Services)	Subordinated Debt (13.5%,			
	Due 8/13 8/14)	46,356	46,136	46,136
	Common Stock (23,926 shares)[12]		23,926	23,868
	Warrant[12]			
	Total Investment		**85,004**	**84,946**

The Hillman Companies, Inc.[3]	Subordinated Debt (10.0%, Due 9/11)	44,580	44,458	44,458
(Consumer Products)	**Total Investment**		**44,458**	**44,458**
The Homax Group, Inc.	Senior Loan (8.7%, Due 10/12)	10,969	10,969	10,969
(Consumer Products)	Subordinated Debt (12.0%, Due 4/14)	14,000	13,244	13,244
	Preferred Stock (89 shares)		89	13
	Common Stock (28 shares)		6	
	Warrants		1,106	194
	Total Investment		**25,414**	**24,420**
Ideal Snacks Corporation	Senior Loan (9.0%, Due 6/10)	288	288	288
(Consumer Products)	**Total Investment**		**288**	**288**
Integrity Interactive Corporation	Unitranche Debt (10.5%, Due 2/12)	12,193	12,095	12,095
(Business Services)	**Total Investment**		**12,095**	**12,095**
International Fiber Corporation	Subordinated Debt (14.0%, Due 6/12)	24,572	24,476	24,476
(Industrial Products)	Preferred Stock (25,000 shares)		2,500	2,194
	Total Investment		**26,976**	**26,670**

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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, 2007 Principal	Cost	Value
Jones Stephens Corporation	Senior Loan (8.8%, Due 9/12)	$ 5,537	$ 5,525	$ 5,525
(Consumer Products)	**Total Investment**		**5,525**	**5,525**
Knightsbridge CLO 2007-1 Limited[4]	Subordinated Debt (14.1%, Due 1/22)	22,000	22,000	22,000
(CLO)	Income Notes (15.2%)[11]		31,211	31,211
	Total Investment		**53,211**	**53,211**
Kodiak Fund LP[5]	Equity Interests		9,423	2,853
(Private Equity Fund)	**Total Investment**		**9,423**	**2,853**
Line-X, Inc.	Senior Loan (12.0%, Due 8/11)	900	885	885
(Consumer Products)	Unitranche Debt (12.0% Due 8/11)	48,198	48,039	42,784
	Total Investment		**48,924**	**43,669**
	Standby Letter of Credit ($1,500)			
MedAssets, Inc.[3]	Common Stock (224,817 shares)		2,049	6,652
(Business Services)	**Total Investment**		**2,049**	**6,652**
Mid-Atlantic Venture Fund IV, L.P.[5]	Limited Partnership Interest		6,975	1,791
(Private Equity Fund)	**Total Investment**		**6,975**	**1,791**
Milestone AV Technologies, Inc.	Subordinated Debt (11.3%, Due 6/13)	37,500	37,500	36,750
(Business Services)	**Total Investment**		**37,500**	**36,750**

NetShape Technologies, Inc.	Senior Loan (8.6%, Due 2/13)	5,802	5,773	5,773
(Industrial Products)	**Total Investment**		**5,773**	**5,773**
Network Hardware Resale, Inc.	Unitranche Debt (10.5%, Due 12/11)	20,512	20,614	20,614
(Business Services)	Convertible Subordinated Debt (9.8%, Due 12/15)	13,242	13,302	15,586
	Total Investment		**33,916**	**36,200**
Norwesco, Inc.	Subordinated Debt (12.7%, Due 1/12 7/12)	82,924	82,674	82,674
(Industrial Products)	Common Stock (559,603 shares)(12)		38,313	117,831
	Warrants(12)			
	Total Investment		**120,987**	**200,505**
Novak Biddle Venture Partners III, L.P.(5)	Limited Partnership Interest		1,910	1,256
(Private Equity Fund)	**Total Investment**		**1,910**	**1,256**
Oahu Waste Services, Inc.	Stock Appreciation Rights		239	998
(Business Services)	**Total Investment**		**239**	**998**

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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, 2007 Principal**	**Cost**	**Value**
Odyssey Investment Partners Fund III, LP[5]	Limited Partnership Interest		$ 2,276	$ 2,567
(Private Equity Fund)	**Total Investment**		**2,276**	**2,567**
Pangaea CLO 2007-1 Ltd.[4]	Subordinated Debt (10.2%, Due 10/21)	$ 15,000	11,570	11,570
(CLO)	**Total Investment**		**11,570**	**11,570**
Passport Health				
Communications, Inc.	Preferred Stock (651,381 shares)		2,000	2,433
(Healthcare Services)	Common Stock (19,680 shares)		48	7
	Total Investment		**2,048**	**2,440**
PC Helps Support, LLC	Senior Loan (8.9%, Due 12/13)	20,000	20,000	20,000
(Business Services)	Subordinated Debt (13.3%, Due 12/13)	30,895	30,743	30,743
	Total Investment		**50,743**	**50,743**
Pendum, Inc.	Subordinated Debt (17.0%, Due 1/11)[6]	34,028	34,028	
(Business Services)	Preferred Stock (82,715 shares)			
	Warrants			
	Total Investment		**34,028**	
Performant Financial Corporation	Common Stock (478,816 shares)		734	
(Business Services)	**Total Investment**		**734**	
PharMEDium Healthcare Corporation	Senior Loan (8.6%, Due 10/13)	19,577	19,577	19,577

(Healthcare Services)	**Total Investment**		**19,577**	**19,577**
Postle Aluminum Company, LLC	Unitranche Debt (11.0%, Due 10/12)	61,500	61,252	61,252
(Industrial Products)	Equity Interests		2,500	3,092
	Total Investment		**63,752**	**64,344**
Pro Mach, Inc.	Subordinated Debt (13.0%, Due 6/12)	14,562	14,506	14,506
(Industrial Products)	Equity Interests		1,500	1,596
	Total Investment		**16,006**	**16,102**
Promo Works, LLC	Unitranche Debt (10.3%, Due 12/11)	26,215	26,006	26,006
(Business Services)	Guaranty ($600)			
	Total Investment		**26,006**	**26,006**
Reed Group, Ltd.	Senior Loan (8.7%, Due 12/13)	21,000	20,970	20,970
(Healthcare Services)	Subordinated Debt (13.8%, Due 12/13)	18,000	17,910	17,910
	Equity Interests		1,800	1,800
	Total Investment		**40,680**	**40,680**
S.B. Restaurant Company	Unitranche Debt (9.8%, Due 4/11)	34,001	33,733	33,733
(Retail)	Preferred Stock (54,125 shares)		135	135
	Warrants		619	2,095
	Standby Letters of Credit ($2,540)			
	Total Investment		**34,487**	**35,963**

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(5) Non-registered investment company.

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

Private Finance Portfolio Company (in thousands, except number of shares)	Investment(1)(2)	December 31, 2007 Principal	Cost	Value
SBBUT, LLC	Equity Interests		$	$
(Consumer Products)	**Total Investment**			
Service Center Metals, LLC	Subordinated Debt (15.5%, Due 9/11)	$ 5,000	4,981	4,981
(Industrial Products)	Equity Interests		313	343
	Total Investment		**5,294**	**5,324**
Snow Phipps Group, L.P.(5)	Limited Partnership Interest		2,288	2,288
(Private Equity Fund)	**Total Investment**		**2,288**	**2,288**
SPP Mezzanine Funding, L.P.(5)	Limited Partnership Interest		2,268	1,942
(Private Equity Fund)	**Total Investment**		**2,268**	**1,942**
SPP Mezzanine Funding II, L.P.(5)	Limited Partnership Interest		4,077	3,731
(Private Equity Fund)	**Total Investment**		**4,077**	**3,731**
Stag-Parkway, Inc.	Unitranche Debt (10.8%, Due 7/12)	51,000	50,810	50,810
(Business Services)	**Total Investment**		**50,810**	**50,810**
STS Operating, Inc.	Subordinated Debt (11.0%, Due 1/13)	30,386	30,273	30,273
(Industrial Products)	**Total Investment**		**30,273**	**30,273**
Summit Energy Services, Inc.	Senior Loan (8.5%, Due 8/13)	24,239	24,239	23,512
(Business Services)	Subordinated Debt (11.6%, Due 8/13)	35,765	35,596	35,596
	Common Stock (89,406 shares)		2,000	1,995

	Total Investment		**61,835**	**61,103**
Tappan Wire and Cable Inc.	Unitranche Debt (15.0%, Due 8/14)	24,100	23,975	23,975
(Business Services)	Common Stock (15,000 shares)[12]		2,250	5,810
	Warrant[12]			
	Total Investment		**26,225**	**29,785**
The Step2 Company, LLC	Unitranche Debt (11.0%, Due 4/12)	96,041	95,693	95,693
(Consumer Products)	Equity Interests		2,483	2,987
	Total Investment		**98,176**	**98,680**
Tradesmen International, Inc.	Subordinated Debt (12.0%, Due 12/12)	49,124	48,431	48,431
(Business Services)	**Total Investment**		**48,431**	**48,431**
TransAmerican Auto Parts, LLC	Subordinated Debt (14.0%, Due 11/12)	24,076	23,907	23,907
(Consumer Products)	Equity Interests		1,198	1,014
	Total Investment		**25,105**	**24,921**
Trover Solutions, Inc.	Subordinated Debt (12.0%, Due 11/12)	60,000	59,740	59,740
(Business Services)	**Total Investment**		**59,740**	**59,740**
Universal Air Filter Company	Subordinated Debt (12.0%, Due 11/12)	14,750	14,688	14,688
(Industrial Products)	**Total Investment**		**14,688**	**14,688**

(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.

(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, 2007 Principal	Cost	Value
Updata Venture Partners II, L.P.[5]	Limited Partnership Interest		$ 4,465	$ 4,306
(Private Equity Fund)	**Total Investment**		**4,465**	**4,306**
Venturehouse-Cibernet Investors, LLC	Equity Interest			54
(Business Services)	**Total Investment**			**54**
Venturehouse Group, LLC[5]	Equity Interest			613
(Private Equity Fund)	**Total Investment**			**613**
VICORP Restaurants, Inc.	Warrants		33	
(Retail)	**Total Investment**		**33**	
Walker Investment Fund II, LLLP[5]	Limited Partnership Interest		1,330	
(Private Equity Fund)	**Total Investment**		**1,330**	
WMA Equity Corporation and Affiliates	Subordinated Debt (13.6%, Due 4/13)	$ 125,000	124,010	124,010
d/b/a Wear Me Apparel	Subordinated Debt (9.0%, Due 4/14)[6]	13,033	13,033	13,302
(Consumer Products)	Common Stock (100 shares)		46,046	13,726
	Total Investment		**183,089**	**151,038**
Webster Capital II, L.P.[5]	Limited Partnership Interest		897	897
(Private Equity Fund)	**Total Investment**		**897**	**897**
Woodstream Corporation	Subordinated Debt (12.0%, Due 2/15)	90,000	89,574	89,574

(Consumer Products)	Common Stock (7,500 shares)		7,500	7,482
	Total Investment		**97,074**	**97,056**
York Insurance Services Group, Inc.	Subordinated Debt (14.5%, Due 1/14)	45,141	44,966	44,966
(Business Services)	Common Stock (15,000 shares)		1,500	1,995
	Total Investment		**46,466**	**46,961**
Other companies	Other debt investments	159	57	62
	Other equity investments		8	
	Total Investment		65	62
Total companies less than 5% owned			**$ 2,994,880**	**$ 2,990,732**
Total private finance (156 portfolio investments)			**$ 5,043,882**	**$ 4,659,321**

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

	Stated Interest Rate Ranges	Number of Loans	December 31, 2007 Cost	Value
Commercial Mortgage Loans				
	Up to 6.99%	3	$ 20,361	$ 19,842
	7.00%-8.99%	8	22,768	22,768
	9.00%-10.99%	3	8,372	8,372
	11.00%-12.99%	1	10,456	10,456
	15.00% and above	2	3,970	3,970
Total commercial mortgage loans[13]		17	$ 65,927	$ 65,408
Real Estate Owned			$ 15,272	$ 21,253
Equity Interests[2] Companies more than 25% owned			$ 15,743	$ 34,539
Guarantees ($6,871)				
Standby Letter of Credit ($1,295)				
Total commercial real estate finance			$ 96,942	$ 121,200
Total portfolio			$ 5,140,824	$ 4,780,521

	Yield	Cost	Value
Investments in U.S. Treasury Bills, Money Market and Other Securities			
American Beacon Money Market Select FD Fund	4.5%	$ 126,910	$ 126,910
American Beacon Money Market Fund	4.8%	40,163	40,163
SEI Daily Income Tr Prime Obligation Money Market Fund	4.9%	34,143	34,143
Columbia Treasury Reserves Money Market Fund	4.6%	6	6
Total		$ 201,222	$ 201,222

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

(13) Commercial mortgage loans totaling $14.3 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
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Information at and for the three months ended March 31, 2008 and 2007 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.

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 2007 balances to conform with the 2008 financial statement presentation.

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 March 31, 2008, the results of operations for the three months ended March 31, 2008 and 2007, and changes in net assets and cash flows for the three months ended March 31, 2008 and 2007. The results of operations for the three months ended March 31, 2008, 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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2. Summary of Significant Accounting Policies, continued

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 U.S. treasury bills, 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.

Valuation Of Portfolio Investments

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 Investment Company Act of 1940 and FASB Statement No. 157, *Fair Value Measurements* (SFAS 157 or the Statement). 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 assumed to be sold in the principal market to market participants, or in the absence of a principal market, the most advantageous market, which may be a hypothetical market. Market participants are defined as buyers and sellers in the principal or most advantageous market that are independent, knowledgeable, and willing and able to transact. In accordance with the Statement, 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 will continue to use the enterprise value methodology to determine the fair value of these investments under SFAS 157. Enterprise value means the entire value of the company to a market participant, including the sum of the values of debt and equity securities used to capitalize the enterprise at a point in time. Enterprise value is determined using various factors, including cash flow from operations of the portfolio company, multiples at which private companies are bought and sold, and other pertinent factors, such as recent offers to purchase a portfolio company, recent transactions involving the purchase or sale of the portfolio company s equity securities, liquidation events, or other events. The Company allocates the enterprise value to these securities in order of the legal priority of the securities.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2. Summary of Significant Accounting Policies, continued

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 in a hypothetical market to a hypothetical market participant (the in-exchange premise of value). 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 is generally shorter than the legal maturity of the instruments as the Company s loans have historically been repaid prior to the maturity date. The yield analysis considers changes in interest rates and changes in leverage levels of the loan or debt security as compared to market interest rates and leverage levels. Assuming the credit quality of the loan or debt security remains stable, the Company will use the value determined by the yield analysis as the fair value for that security. A change in the assumptions that the Company uses to estimate the fair value of its loans and debt securities using the yield analysis could have a material impact on the determination of fair value. If there is deterioration in credit quality or a loan or debt security is in workout status, the Company may consider other factors in determining the fair value of a loan or debt security, including the value attributable to the loan or debt security from the enterprise value of the portfolio company or the proceeds that would be received in a liquidation analysis.

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

The fair value of the Company s CLO bonds and preferred shares/income notes and CDO bonds (CLO/ CDO Assets) is generally based on a discounted cash flow model that utilizes prepayment, re-investment and loss assumptions based on historical experience and projected performance, economic factors, the characteristics of the underlying cash flow, and comparable yields for similar bonds and preferred shares/ income notes, when available. 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 or loss assumptions in the underlying collateral pool. The Company determines the fair value of its CLO/ CDO Assets on an individual security-by-security basis.

The Company will record unrealized depreciation on investments when it determines that the fair value of a security is less than its cost basis, and will record 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.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2. Summary of Significant Accounting Policies, continued

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 and depreciation on accrued interest and dividends receivable and other assets where collection is doubtful.

Interest and Dividend Income

Interest income is recorded on an accrual basis to the extent that such amounts are expected to be collected. For loans and debt securities with contractual payment-in-kind interest, which represents contractual interest accrued and added to the loan balance that generally becomes due at maturity, the Company will not accrue payment-in-kind interest if the portfolio company valuation indicates that the payment-in-kind interest is not collectible. In general, interest is not accrued on loans and debt securities if the Company has doubt about interest collection or where the enterprise value of the portfolio company may not support further accrual. Loans in workout status do not accrue interest. In addition, 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 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.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2. Summary of Significant Accounting Policies, continued

Fee Income

Fee income includes fees for loan prepayment premiums, guarantees, commitments, and services rendered by the Company to portfolio companies and other third parties such as diligence, structuring, transaction services, management and consulting services, and other services. Loan prepayment premiums are recognized at the time of prepayment. Guaranty and commitment fees are generally recognized as income over the related period of the guaranty or commitment, respectively. Diligence, structuring, and transaction services fees are generally recognized as income when services are rendered or when the related transactions are completed. Management, consulting and other services fees, including fund management fees, are generally recognized as income as the services are rendered. Fees are not accrued if the Company has doubt about collection of those fees.

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 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 record 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 months ended March 31, 2008 and 2007, was as follows:

($ in millions, except per share amounts)	2008	2007
Employee Stock Option Expense:		
Previously awarded, unvested options as of January 1, 2006	$ 1.7	$ 3.2
Options granted on or after January 1, 2006	2.5	0.5
Total employee stock option expense	$ 4.2	$ 3.7
Per basic share	$ 0.03	$ 0.02
Per diluted share	$ 0.03	$ 0.02

The stock option expense for options granted for 2008 and 2007 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 months ended March 31, 2008 and 2007:

	2008	2007[(1)]
Expected term (in years)	5.0	
Risk-free interest rate	2.7%	%
Expected volatility	27.6%	%
Dividend yield	8.5%	%
Weighted average fair value per option	$ 2.19	$

(1) The Company did not grant any options during the three months ended March 31, 2007.

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 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 the Company s historical dividend yield over a historical time period consistent with the expected term.

To determine the stock options expense for the 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 for outstanding unvested options as of March 31, 2008, will be $13.2 million, $6.8 million, and $4.0 million for the years ended December 31, 2008, 2009, and 2010, respectively. This estimate may change if the Company s assumptions related to future option forfeitures change. This estimate does not include any expense related to stock option grants after March 31, 2008, 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 March 31, 2008, is expected to be recognized over an estimated weighted-average period of 1.8 years.

Federal and State Income Taxes and Excise Tax

The Company intends to comply with the requirements of the Code that are applicable to regulated investment companies (RIC) and real estate investment trusts (REIT). ACC and any subsidiaries

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2. Summary of Significant Accounting Policies, continued

that qualify as a RIC or a REIT intend to distribute or retain through a deemed distribution all of their annual taxable income to shareholders; therefore, the Company has made no provision for income taxes exclusive of excise taxes for these entities.

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

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

Per Share Information

Basic earnings per common share is calculated using the weighted average number of common shares outstanding for the period presented. Diluted earnings per common share reflects the potential dilution that could occur if options to issue common stock were exercised into common stock. Earnings per share is computed after subtracting dividends on preferred shares, if any.

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 $4.6 billion and $4.8 billion at March 31, 2008, and December 31, 2007, respectively. At March 31, 2008, and December 31, 2007, 91% and 92%, 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

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2. Summary of Significant Accounting Policies, continued

fiscal years. The Company has adopted this statement on a prospective basis beginning in the quarter ended March 31, 2008. Adoption of this statement did not have a material effect on the Company s consolidated financial statements for the period ended March 31, 2008. However, the impact on its consolidated financial statements for periods subsequent to the period of adoption cannot be determined at this time as it will be influenced by the estimates of fair value for those periods, the number and amount of investments the Company originates, acquires or exits, and the effect of any additional guidance or any changes in the interpretation of this statement.

In February 2007, the FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115.* This statement 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 is 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 are already measured at fair value, therefore, the adoption of this statement did not impact the Company s consolidated financial position or its results of operations.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3. Portfolio

Private Finance

At March 31, 2008, and December 31, 2007, the private finance portfolio consisted of the following:

	2008			2007		
($ in millions)	**Cost**	**Value**	**Yield[1]**	**Cost**	**Value**	**Yield[1]**
Loans and debt securities:						
Senior loans	$ 358.5	$ 325.7	7.0%	$ 374.1	$ 344.3	7.7%
Unitranche debt[2]	656.5	655.7	11.8%	659.2	653.9	11.5%
Subordinated debt	2,655.6	2,430.4	13.0%	2,576.4	2,416.4	12.8%
Total loans and debt securities[3]	3,670.6	3,411.8	12.2%	3,609.7	3,414.6	12.1%
Equity securities:						
Preferred shares/income notes of CLOs[4]	224.1	197.4	15.8%	218.3	203.0	14.6%
Subordinated certificates in Unitranche Fund LLC[4]	31.5	31.5	12.4%	0.7	0.7	12.4%
Other equity securities	1,093.1	879.1		1,215.2	1,041.0	
Total equity securities	1,348.7	1,108.0		1,434.2	1,244.7	
Total	$ 5,019.3	$ 4,519.8		$ 5,043.9	$ 4,659.3	

(1) The weighted average yield on loans and debt securities is computed as the (a) annual stated interest on accruing loans and debt securities 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 March 31, 2008, and December 31, 2007, the cost and value of subordinated debt included the Class A equity interests in Ciena Capital LLC, which were placed on non-accrual status during the fourth quarter of 2006.

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 Unitranche Fund LLC is computed as the (a) annual stated interest (LIBOR plus 7.5%) 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) The total principal balance outstanding on loans and debt securities was $3,697.4 million and $3,639.6 million at March 31, 2008, and December 31, 2007, respectively. The difference between principal and cost is represented by

unamortized loan origination fees and costs, original issue discounts, and market discounts totaling $26.8 million and $29.9 million at March 31, 2008, and December 31, 2007, respectively.

(4) Investments in the preferred shares/income notes of CLOs and the subordinated certificates in Unitranche 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 are generally issued by private companies and are generally 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 March 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. At December 31, 2007, 86% of the private finance loans and debt securities had a fixed rate of interest and 14% 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 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 is generally 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 is generally paid to the Company quarterly.

Equity securities consist primarily 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, in conjunction with its debt investments. The Company may also 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 (Ciena) focuses on loan products that provide financing to commercial real estate owners and operators. Ciena is also 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.

At March 31, 2008, the Company s investment in Ciena totaled $327.8 million at cost and $29.3 million at value, after the effect of unrealized depreciation of $298.5 million. At December 31, 2007, the Company s investment in Ciena totaled $327.8 million at cost and $68.6 million at value, after the effect of unrealized depreciation of $259.2 million.

Net change in unrealized appreciation or depreciation included a net decrease in the Company s investment in Ciena of $39.3 million for the three months ended March 31, 2008, and no change in the unrealized depreciation on the Company s investment in Ciena for the three months ended March 31, 2007.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3. Portfolio, continued

Total interest and related portfolio income earned from the Company s investment in Ciena for the three months ended March 31, 2008 and 2007, was as follows:

($ in millions)	2008	2007
Interest income on subordinated debt and Class A equity interests	$	$
Fees and other income		1.4
Total interest and related portfolio income	$	$ 1.4

In the fourth quarter of 2006, the Company placed its investment in Ciena s 25% Class A equity interests on non-accrual status. As a result, there was no interest income from the Company s investment in Ciena for the three months ended March 31, 2008 and 2007. In consideration for providing a guaranty on Ciena s revolving credit facility and standby letters of credit (discussed below), the Company earned fees of $1.4 million for the three months ended March 31, 2007, and $5.4 million for the year ended December 31, 2007, which were included in fees and other income. Ciena has not yet paid the $5.4 million in such fees earned by the Company during 2007, and at March 31, 2008, such fees were included as a receivable in other assets. The Company considered this outstanding receivable in its valuation of Ciena at March 31, 2008. The Company did not accrue the fees earned from Ciena for providing the guaranty and standby letters of credit for the three months ended March 31, 2008.

The Company guarantees Ciena s revolving credit facility that matures in March 2009. On January 30, 2008, Ciena completed an amendment of the terms of its revolving credit facility. The amendment reduced the commitments from the lenders under the facility from $500 million to $450 million at the effective date of the amendment, with further periodic reductions in total commitments to $325 million by December 31, 2008. In addition, certain financial and other covenants were amended. In connection with this amendment, the Company increased its unconditional guarantee from 60% to 100% of the total obligations under this facility (consisting of principal, letters of credit issued under the facility, accrued interest, and other fees) and replaced $42.5 million in letters of credit issued under the Ciena credit facility with new letters of credit under the Company s revolving line of credit. The guaranty of the Ciena revolving credit facility can be called by the lenders in the event of a default, which includes the occurrence of any event of default under the Company s revolving credit facility, subject to grace periods in certain cases. The amendment also prohibits cash payments from Ciena to the Company for interest, guarantee fees, management fees, and dividends. At March 31, 2008, the principal amount outstanding on Ciena s revolving credit facility was $335.0 million and letters of credit issued under the facility were $46.9 million. The total obligation guaranteed by the Company at March 31, 2008, was $384.8 million. At March 31, 2008, the Company had provided standby letters of credit totaling $59.5 million in connection with term securitization transactions completed by Ciena.

Ciena relies on the asset-backed securitization market to finance its loan origination activity. That financing source continues to be unreliable in the current capital markets, and as a result, Ciena has substantially curtailed loan origination activity, including loan originations under the SBA s 7(a) Guaranteed Loan Program. Ciena continues to reposition its business. However, there is an inherent risk in this repositioning and the Company continues to work with Ciena on restructuring. Ciena maintains two non-recourse securitization warehouse facilities, and there is no assurance that Ciena will be able to refinance these facilities in the loan securitization market. 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 Ciena s failure to perform any of its obligations as loan originator, loan seller or loan servicer under the warehouse securitizations.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3. Portfolio, continued

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. Specifically, on or about January 9, 2007, Ciena became aware of an indictment captioned as the United States v. Harrington, No. 2:06-CR-20662 pending in the United States District Court for the Eastern District of Michigan. The indictment alleged that a former Ciena employee in the Detroit office engaged in the fraudulent origination of loans guaranteed, in substantial part, by the SBA. The Company understands that Ciena is working cooperatively with the U.S. Attorney s Office and the investigating agencies with respect to this matter. On October 1, 2007, the former Ciena employee pled guilty to one count of conspiracy to fraudulently originate SBA-guaranteed loans and one count of making a false statement before a grand jury.

On March 6, 2007, Ciena entered into an agreement with the SBA. According to the agreement, Ciena remains a preferred lender in the SBA 7(a) Guaranteed Loan Program and retains the ability to sell loans into the secondary market. As part of this agreement, Ciena agreed to the immediate payment of approximately $10 million to the SBA to cover amounts paid by the SBA with respect to some of the SBA-guaranteed loans that have been the subject of the charges by the U.S. Attorney s Office for the Eastern District of Michigan against Mr. Harrington. Ciena also entered into an escrow agreement with the SBA and an escrow agent in which Ciena agreed to deposit $10 million with the escrow agent for any additional payments Ciena may be obligated to pay to the SBA in the future under the agreement. During the term of the agreement, any loans originated by Ciena that will be sold into the secondary market or loans that default after having been sold into the secondary market will be reviewed by an independent third party selected by the SBA prior to the sale of such loans into the secondary market or prior to reimbursement by the SBA. Ciena remains subject to SBA rules and regulations and as a result may be required to make additional payments to the SBA in the ordinary course of business.

As an SBA lender, Ciena is also subject to other SBA and OIG audits, investigations, and reviews. In addition, the Office of the Inspector General of the U.S. Department of Agriculture is conducting an investigation of Ciena s lending practices under the Business and Industry Loan (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. These investigations, audits and reviews are ongoing.

On or about January 16, 2007, Ciena (f/k/a Business Loan Express, LLC) and its subsidiary Business Loan Center LLC (BLC) became aware of a lawsuit titled, United States, ex rel James R. Brickman and Greenlight Capital, Inc. v. Business Loan Express LLC f/k/a Business Loan Express, Inc.; Business Loan Center LLC f/k/a Business Loan Center, Inc.; Robert Tannenhauser; Matthew McGee; and George Harrigan, 05-CV-3147 (JEC). The complaint includes allegations arising under the False Claims Act and relating to alleged fraud in connection with SBA guarantees on shrimp vessel loans. On December 18, 2007, the United States District Court for the Northern District of Georgia dismissed all claims in this matter. The plaintiffs are appealing the dismissal.

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 current regulatory issues, ongoing investigations, litigation, and the repositioning of its business in performing the valuation of Ciena at March 31, 2008. The Company is monitoring the situation.

At both March 31, 2008, and December 31, 2007, the Company held all of the Class A equity interests, all of the Class B equity interests and 94.9% of the Class C equity interests.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3. Portfolio, continued

Mercury Air Centers, Inc. In April 2004, the Company completed the purchase of a majority ownership in Mercury Air Centers, Inc. (Mercury). At March 31, 2007, the Company s investment in Mercury totaled $84.8 million at cost and $301.4 million at value, which included unrealized appreciation of $216.6 million.

In August 2007, the Company completed the sale of its majority equity interest in Mercury. For the year ended December 31, 2007, the Company realized a gain of $262.4 million, subject to post-closing adjustments. In addition, the Company was repaid approximately $51 million of subordinated debt outstanding to Mercury at closing.

Mercury owned and operated fixed base operations generally under long-term leases from local airport authorities, which consisted of terminal and hangar complexes that serviced the needs of the general aviation community. Mercury was headquartered in Richmond Heights, OH.

Total interest and related portfolio income earned from the Company s investment in Mercury for the three months ended March 31, 2007, was as follows:

($ in millions)	**2007**
Interest income	$ 2.0
Fees and other income	0.1
Total interest and related portfolio income	$ 2.1

Net change in unrealized appreciation or depreciation for the three months ended March 31, 2007, included an increase in unrealized appreciation totaling $56.7 million related to the Company s investment in Mercury.

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 March 31, 2008, and December 31, 2007, the Company owned bonds and preferred shares/income notes in CLOs and bonds in a CDO as follows:

	2008			2007		
($ in millions)	**Cost**	**Value**	**Yield[(1)]**	**Cost**	**Value**	**Yield[(1)]**
Bonds[(2)]:						
Callidus Debt Partners CDO Fund I, Ltd.	$ 28.4	$ 28.5	14.0%	$ 28.4	$ 28.5	14.0%
Callidus Debt Partners CLO Fund IV, Ltd.	2.0	2.6	10.1%			
Callidus Debt Partners CLO Fund VI, Ltd.	4.3	4.5	13.1%	4.3	4.3	13.4%
Callidus MAPS CLO Fund I LLC	17.0	15.5	8.9%	17.0	16.1	11.0%
Dryden XVIII Leveraged Loan 2007 Limited	7.4	8.2	11.4%	7.4	7.4	12.7%
Knightsbridge CLO 2007-1 Limited	22.0	22.0	14.1%	22.0	22.0	14.1%
Pangaea CLO 2007-1 Ltd.	11.6	10.8	13.1%	11.6	11.6	13.9%
Total bonds	92.7	92.1	12.7%	90.7	89.9	13.3%
Preferred Shares/ Income Notes:						
Callidus Debt Partners CLO Fund III, Ltd.	21.4	20.0	16.4%	21.8	20.0	14.1%
Callidus Debt Partners CLO Fund IV, Ltd.	15.2	14.9	17.5%	12.3	11.3	16.1%
Callidus Debt Partners CLO Fund V, Ltd.	13.8	13.8	20.3%	14.0	14.7	19.3%
Callidus Debt Partners CLO Fund VI, Ltd.	28.3	26.5	19.2%	27.0	27.0	19.3%
Callidus Debt Partners CLO Fund VII, Ltd.	23.1	23.1	16.6%	22.1	22.1	16.6%
Callidus MAPS CLO Fund I LLC	48.4	31.5	5.6%	49.3	36.1	7.6%
Callidus MAPS CLO Fund II, Ltd.	18.8	16.8	17.6%	18.7	18.7	14.7%
Dryden XVIII Leveraged Loan 2007 Limited	22.7	19.8	14.6%	21.9	21.9	14.2%
Knightsbridge CLO 2007-1 Limited	32.4	31.0	19.3%	31.2	31.2	15.2%
Total preferred shares/income notes	224.1	197.4	15.8%	218.3	203.0	14.6%
Total	$ 316.8	$ 289.5		$ 309.0	$ 292.9	

(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.

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 distributed to the preferred shareholders and income note holders. To the extent there are defaults and unrecoverable losses on the underlying collateral assets that result in reduced cash flows, the preferred shares/income notes will bear this loss first and then the subordinated bonds would bear any loss after the preferred

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3. Portfolio, continued
shares/income notes. At both March 31, 2008, and December 31, 2007, the face value of the CLO and CDO assets held by the Company was subordinate to as much as 94% of the face value of the securities outstanding in these CLOs and CDO.

At March 31, 2008, and December 31, 2007, the underlying collateral assets of these CLO and CDO issuances, consisting primarily of senior corporate loans, were issued by 636 issuers and 671 issuers, respectively, and had balances as follows:

($ in millions)	2008	2007
Bonds	$ 286.1	$ 288.5
Syndicated loans	4,206.5	4,122.7
Cash[(1)]	101.4	104.4
Total underlying collateral assets[(2)]	$ 4,594.0	$ 4,515.6

(1) Includes undrawn liability amounts.

(2) At March 31, 2008, and December 31, 2007, the total face value of defaulted obligations was $42.3 million and $18.4 million, respectively, or approximately 0.9% and 0.4% respectively, of the total underlying collateral assets.

Loans and Debt Securities on Non-Accrual Status. At March 31, 2008, and December 31, 2007, private finance loans and debt securities at value not accruing interest were as follows:

($ in millions)	2008	2007
Loans and debt securities in workout status		
Companies more than 25% owned	$ 62.4	$ 114.1
Companies 5% to 25% owned	2.6	11.7
Companies less than 5% owned	23.3	23.8
Loans and debt securities not in workout status		
Companies more than 25% owned	31.0	21.4
Companies 5% to 25% owned	12.3	13.4
Companies less than 5% owned	11.7	13.3
Total	$ 143.3	$ 197.7

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3. Portfolio, continued

Industry and Geographic Compositions. The industry and geographic compositions of the private finance portfolio at value at March 31, 2008, and December 31, 2007, were as follows:

	2008	2007
Industry		
Business services	36%	37%
Consumer products	25	25
Industrial products	8	10
Financial services	5	6
CLO/ CDO[1]	6	6
Retail	5	4
Consumer services	5	4
Healthcare services	3	3
Asset management	2	1
Other	5	4
Total	100%	100%
Geographic Region[2]		
Mid-Atlantic	35%	36%
Midwest	31	32
Southeast	18	17
West	14	14
Northeast	2	1
Total	100%	100%

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

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

Commercial Real Estate Finance

At March 31, 2008, and December 31, 2007, the commercial real estate finance portfolio consisted of the following:

	2008			2007		
($ in millions)	**Cost**	**Value**	**Yield[1]**	**Cost**	**Value**	**Yield[1]**
Commercial mortgage loans	$ 52.0	$ 53.5	7.9%	$ 65.9	$ 65.4	6.8%
Real estate owned	23.5	30.2		15.3	21.3	

Equity interests	14.2	32.1	15.7	34.5
Total	$ 89.7	$ 115.8	$ 96.9	$ 121.2

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3. Portfolio, continued

Commercial Mortgage Loans and Equity Interests. The commercial mortgage loan portfolio contains loans that were originated by the Company or were purchased from third-party sellers. At both March 31, 2008, and December 31, 2007, approximately 85% and 15% of the Company s commercial mortgage loan portfolio was composed of fixed and adjustable interest rate loans, respectively. At March 31, 2008, and December 31, 2007, loans with a value of $7.4 million and $14.3 million, respectively, were not accruing interest. Loans greater than 120 days delinquent generally do not accrue interest.

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

The property types and the geographic composition securing the commercial real estate finance portfolio at value at March 31, 2008, and December 31, 2007, were as follows:

	2008	2007
Property Type		
Hospitality	44%	44%
Office	20	21
Retail	18	18
Recreation	16	15
Other	2	2
Total	100%	100%
Geographic Region		
Southeast	44%	40%
Midwest	25	31
West	21	20
Northeast	8	7
Mid-Atlantic	2	2
Total	100%	100%

Fair Value Measurements

In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements* (SFAS 157). This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company has adopted this statement on a prospective basis beginning in the quarter ended March 31, 2008. Adoption of this statement did not have a material effect on the Company s consolidated financial statements for the period ended March 31, 2008.

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 Investment Company Act of 1940 and SFAS 157. The Company determines fair

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3. Portfolio, continued

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

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

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

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

Level 3 Unobservable inputs

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

Assets measured at fair value on a recurring basis by level within the fair value hierarchy at March 31, 2008, were as follows:

($ in millions)	Fair Value Measurement as of March 31, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets at Fair Value:				
U.S. Treasury Bills	$ 120.0	$ 120.0	$	$
Portfolio				
Private finance	$ 4,519.8	$ 3.3	$	$ 4,516.5
Commercial real estate finance	115.8			115.8
Total portfolio	$ 4,635.6	$ 3.3	$	$ 4,632.3

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3. Portfolio, continued

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

($ in millions)	Private Finance	Commercial Real Estate Finance	Total
Balance at December 31, 2007	$ 4,652.7	$ 121.2	$ 4,773.9
Total gains or losses			
Net realized gains (losses)(1)	12.8	(0.2)	12.5
Net change in unrealized appreciation or depreciation(2)	(111.4)	1.9	(109.5)
Purchases, issuances, repayments and exits, net(3)	(37.6)	(7.1)	(44.6)
Transfers in and/or out of level 3			
Balance at March 31, 2008	$ 4,516.5	$ 115.8	$ 4,632.3
Net unrealized appreciation (depreciation) during the period relating to assets still held at the reporting date (2)	$ (93.5)	$ 1.5	$ (92.0)

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

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

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

The impact on the Company s consolidated financial statements for periods subsequent to the period of adoption of SFAS 157 cannot be determined at this time as it will be influenced by the estimates of fair value for those periods, the number and amount of investments the Company originates, acquires or exits, and the effect of any additional guidance or any changes in the interpretation of the statement.

Managed Funds

The Company manages funds that invest in the debt and equity of primarily private middle market companies in a variety of industries (together, the Managed Funds). As of March 31, 2008, the funds that the Company manages had total assets of approximately $1.2 billion. During 2007, the Company established the Allied Capital Senior Debt Fund, L.P. and the Unitranche Fund LLC, and in the first quarter of 2008, the Company formed the AGILE Fund I, LLC and assumed the management of Knightsbridge as 2007-1 Ltd., all discussed below. The Company s responsibilities to the Managed Funds may include deal origination, underwriting, and portfolio monitoring and development services consistent with the activities that the Company performs for its portfolio. Each of the Managed Funds may separately invest in the debt or equity of a portfolio company. The Company s portfolio may include debt or equity investments issued by the same portfolio company as investments held by one or more Managed Funds, and these investments may be senior, pari passu or junior to the debt and equity investments held by the Company.

The Company accounts for the sale of securities to funds with which it has continuing involvement as sales pursuant to SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities,* a replacement of FASB Statement 125, when the securities have been legally isolated from the Company, the Company has no ability to restrict or constrain the ability of the

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3. Portfolio, continued

funds to pledge or exchange the transferred securities, and the Company does not have either the entitlement and the obligation to repurchase the securities or the ability to unilaterally cause the fund to put the securities back to the Company.

Allied Capital Senior Debt Fund, L.P. The Company is a special limited partner in the Allied Capital Senior Debt Fund, L.P. (ACSDF), a private fund that generally invests in senior, unitranche and second lien debt. The Company has committed and funded $31.8 million to ACSDF, which is a portfolio company. The Company s investment in ACSDF totaled $31.8 million at cost and $32.6 million at value at March 31, 2008, and $31.8 million at cost and $32.8 million at value at December 31, 2007. ACSDF has closed on $125 million in equity capital commitments and had total assets of approximately $432 million at March 31, 2008. As a special limited partner, the Company expects to earn an incentive allocation of 20% of ACSDF s annual net income earned in excess of a specified minimum return, subject to certain performance benchmarks. The value of the Company s investment in ACSDF is based on the net asset value of ACSDF, which reflects the capital invested plus its allocation of the net earnings of ACSDF, including the incentive allocation.

AC Corp is the investment manager to ACSDF. Callidus Capital Corporation, a portfolio investment controlled by the Company, acts as special manager to ACSDF. An affiliate of the Company is the general partner of ACSDF, and AC Corp serves as collateral manager to a warehouse financing vehicle associated with ACSDF. AC Corp earns a management fee of up to 2% per annum of the net asset value of ACSDF and pays Callidus 25% of that management fee to compensate Callidus for its role as special manager.

The Company may offer to sell loans to ACSDF or the warehouse financing vehicle. ACSDF or the warehouse financing vehicle may purchase loans from the Company. In connection with ACSDF s formation in June 2007 and during the second half of 2007, the Company sold $224.2 million of seasoned assets with a weighted average yield of 10.0% to a warehouse financing vehicle associated with ACSDF. In the first quarter of 2008, the Company sold $30.0 million of seasoned assets with a weighted average yield of 8.2% to the warehouse financing vehicle. ACSDF also purchases loans from other third parties.

Unitranche Fund LLC. In December 2007, the Company formed the Unitranche Fund LLC (Unitranche Fund), which the Company co-manages with an affiliate of General Electric Capital Corporation (GE). The Unitranche Fund is a private fund that generally focuses on making first lien unitranche loans to middle market companies with Earnings before Interest, Taxes, Depreciation, and Amortization of at least $15 million. GE has committed $3.075 billion to the Unitranche Fund consisting of $3.0 billion of senior notes and $0.075 billion of subordinated certificates and the Company has committed $525.0 million of subordinated certificates. The Unitranche Fund will be capitalized as transactions are completed. The Company earns a management and sourcing fee totaling 0.375% per annum of managed assets. At March 31, 2008, the Unitranche Fund had total assets of approximately $142 million and the Company s investment in the Unitranche Fund totaled $31.5 million at cost and at value.

AGILE Fund I, LLC. In January 2008, the Company entered into an investment agreement with the Goldman Sachs Private Equity Group, part of Goldman Sachs Asset Management (Goldman Sachs). As part of the investment agreement, the Company agreed to sell a pro-rata strip of private equity and debt investments to AGILE Fund I, LLC (AGILE), a private fund in which a fund managed by Goldman Sachs owns substantially all of the interests, for a total transaction value of $167 million. The sales of the assets closed in the first quarter of 2008.

The sale to AGILE included 13.7% of the Company s equity investments in 23 of its buyout portfolio companies and 36 of its minority equity portfolio companies for a total purchase price of

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3. Portfolio, continued

$104 million, which resulted in a net realized gain of $8.8 million and dividend income of $5.4 million. In addition, the Company sold approximately $63 million in debt investments, which represented 7.3% of its unitranche, second lien and subordinated debt investments in the buyout investments included in the equity sale. AGILE generally has the right to co-invest in its proportional share of any future follow-on investment opportunities presented by the companies in its portfolio.

The Company is the managing member of AGILE, and is entitled to an incentive allocation subject to certain performance benchmarks. The Company owns the remaining interests in AGILE not held by Goldman Sachs. At March 31, 2008, AGILE had total assets of approximately $174 million and the Company s investment in AGILE totaled $0.9 million at cost and at value.

In addition, pursuant to the investment agreement Goldman Sachs has committed to invest at least $125 million in future investment vehicles managed by the Company and will have future opportunities to invest in the Company s affiliates, or vehicles managed by them, and to coinvest alongside the Company in the future, subject to various terms and conditions.

As part of this transaction, the Company also sold nine venture capital and private equity limited partnership investments for approximately $28 million to a fund managed by Goldman Sachs, which assumed the $4.7 million of unfunded commitments related to these limited partnership investments. The sale of these limited partnership investments closed at the end of the first quarter of 2008 and resulted in a net realized loss of $5.5 million.

Knightsbridge CLO 2007-1 Ltd. On March 31, 2008, the Company assumed the management of Knightsbridge CLO 2007-1 Ltd. The Company earns a management fee of up to 0.6% per annum of the assets of the fund. Callidus may assist the Company in the management of the fund and the Company may pay Callidus a portion of the management fee earned for this assistance. This CLO invests primarily in middle market senior loans. At March 31, 2008, Knightsbridge CLO 2007-1 Ltd. had total assets of approximately $500 million and the Company s investment in this CLO totaled $54.4 million at cost and $53.0 million at value.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 4. Debt

At March 31, 2008, and December 31, 2007, the Company had the following debt:

	2008			2007		
($ in millions)	Facility Amount	Amount Drawn	Annual Interest Cost(1)	Facility Amount	Amount Drawn	Annual Interest Cost(1)
Notes payable and debentures:						
Privately issued unsecured notes payable	$ 1,042.8	$ 1,042.8	6.1%	$ 1,042.2	$ 1,042.2	6.1%
Publicly issued unsecured notes payable	880.0	880.0	6.7%	880.0	880.0	6.7%
Total notes payable and debentures	1,922.8	1,922.8	6.4%	1,922.2	1,922.2	6.4%
Revolving line of credit	922.5	268.8(4)	3.8%(2)	922.5	367.3	5.9%(2)
Total debt	$ 2,845.3	$ 2,191.6	6.2%(3)	$ 2,844.7	$ 2,289.5	6.5%(3)

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

(2) The annual interest cost reflects the interest rate payable for borrowings under the revolving line of credit in effect at the balance sheet date. In addition to the current interest payable, there were annual costs of commitment fees, other facility fees and amortization of debt financing costs of $3.7 million at both March 31, 2008, and December 31, 2007.

(3) The annual interest cost for total debt includes the annual cost of commitment fees, other facility fees and amortization of debt financing costs on the revolving line of credit regardless of the amount outstanding on the facility as of the balance sheet date. The annual interest cost reflects the facilities in place on the balance sheet date.

(4) On April 9, 2008, the Company entered into a three-year unsecured revolving line of credit with total commitments of $632.5 million, which replaced the Company s previous line of credit. Under this new revolving line of credit, in addition to the current interest rate payable, the annual costs of commitment fees, other facility fees and amortization of debt financing costs will be approximately $6.7 million. See discussion below.

Notes Payable and Debentures

Privately Issued Unsecured Notes Payable. The Company has privately issued unsecured long-term notes to institutional investors. The notes have five- or seven-year maturities and have fixed rates of interest. The notes generally require payment of interest only semi-annually, and all principal is due upon maturity. At March 31, 2008, the notes had maturities from May 2008 to May 2013. The notes may be prepaid in whole or in part, together with an interest premium, as stipulated in the note agreements.

The Company also has issued five-year unsecured long-term notes denominated in Euros and Sterling for a total U.S. dollar equivalent of $15.2 million. The notes have fixed interest rates and have substantially the same terms as the Company s other unsecured notes. The Euro notes require annual interest payments and the Sterling notes require semi-annual interest payments until maturity. These notes mature in March 2009. Simultaneous with issuing the notes, the Company entered into a cross currency swap with a financial institution which fixed the Company s interest and principal payments in U.S. dollars for the life of the debt.

Publicly Issued Unsecured Notes Payable. At March 31, 2008, the Company had outstanding publicly issued unsecured notes as follows:

($ in millions)	**Amount**	**Maturity Date**
6.625% Notes due 2011	$ 400.0	July 15, 2011
6.000% Notes due 2012	250.0	April 1, 2012
6.875% Notes due 2047	230.0	April 15, 2047
Total	$ 880.0	

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 4. Debt, continued

The 6.625% Notes due 2011 and the 6.000% Notes due 2012 require payment of interest only semi-annually, and all principal is due upon maturity. The Company has the option to redeem these notes in whole or in part, together with a redemption premium, as stipulated in the notes.

On March 28, 2007, the Company completed the issuance of $200.0 million of 6.875% Notes due 2047 for net proceeds of $193.0 million. In April 2007, the Company issued additional notes, through an over-allotment option, totaling $30.0 million for net proceeds of $29.1 million. Net proceeds are net of underwriting discounts and estimated offering expenses.

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

Scheduled Maturities. Scheduled future maturities of notes payable at March 31, 2008, were as follows:

Year	Amount Maturing ($ in millions)
2008	$ 153.0
2009	270.3
2010	408.0
2011	472.5
2012	339.0
Thereafter	280.0
Total	$ 1,922.8

Revolving Line of Credit

At December 31, 2007, the Company had an unsecured revolving line of credit with a committed amount of $922.5 million that was scheduled to expire on September 30, 2008. On April 9, 2008, the Company entered into a three-year unsecured revolving line of credit with total commitments of $632.5 million, with Bank of America, N.A., as a lender and as administrative agent, and the other lenders thereunder, which replaced the Company s previous revolving line of credit. The Company may obtain additional commitments up to a total committed facility of $1.5 billion, subject to customary conditions. The revolving line of credit expires on April 11, 2011.

At the Company s option, borrowings under the revolving line of credit effective April 9, 2008, generally bear interest at a rate per annum equal to (i) LIBOR (for the period selected by the Company) plus 2.00% or (ii) the higher of the Federal Funds rate plus 0.50% or the Bank of America N.A. prime rate. The revolving line of credit requires the payment of an annual commitment fee equal to 0.50% of the committed amount (whether used or unused). The revolving line of credit generally requires payments of interest at the end of each LIBOR interest period, but no less frequently than quarterly, on LIBOR-based loans, and monthly payments of interest on other loans. All principal is due upon maturity.

The revolving credit facility provides for a swing line sub-facility. The swing line sub-facility bears interest at the Bank of America N.A. cost of funds plus 2.00%. The revolving credit facility also provides for a sub-facility for the issuance of letters of credit for up to an aggregate amount of $175 million. This

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 4. Debt, continued

letter of credit sub-facility will increase to the extent of 15% of the aggregate amount of commitments over $1.0 billion. The letter of credit fee is 2.00% per annum on letters of credit issued, which is payable quarterly.

The annual cost of commitment fees, other facility fees and amortization of debt financing costs prior to entering into the new three-year facility in April 2008, was $3.7 million at both March 31, 2008, and December 31, 2007, respectively. Subsequent to entering into the new facility in April 2008, the annual cost of commitment fees, other facility fees and amortization of debt financing costs will be approximately $6.7 million.

The average debt outstanding on the revolving line of credit was $289.3 million and $142.1 million, respectively, for the three months ended March 31, 2008 and 2007. The maximum amount borrowed under this facility and the weighted average stated interest rate during the three months ended March 31, 2008 and 2007, were $403.8 million and 4.9%, respectively, and $225.5 million and 6.4%, respectively. At March 31, 2008, the amount available under the revolving line of credit in effect on March 31, 2008, was $557.5 million, net of amounts committed for standby letters of credit of $96.3 million issued under the credit facility. On April 9, 2008, the amount available under the new revolving line of credit was $325.4 million, net of amounts committed for standby letters of credit of $96.3 million issued under the credit facility.

Covenant Compliance

The Company has various financial and operating covenants required by the revolving line of credit and the privately issued unsecured notes payable outstanding at March 31, 2008, and December 31, 2007. These covenants require the Company to maintain certain financial ratios, including asset coverage, debt to equity and interest coverage, and a minimum net worth. These credit facilities provide for customary events of default, including, but not limited to, payment defaults, breach of representations or covenants, cross-defaults, bankruptcy events, failure to pay judgments, attachment of the Company s assets, change of control and the issuance of an order of dissolution. Certain of these events of default are subject to notice and cure periods or materiality thresholds. The Company s credit facilities limit its ability to declare dividends if the Company defaults under certain provisions. As of March 31, 2008, and December 31, 2007, the Company was in compliance with these covenants. The financial and operating covenants under the new revolving line of credit are substantially similar to the previous facility.

The Company has certain financial and operating covenants that are required by the publicly issued unsecured notes payable, including that the Company will maintain a minimum ratio of 200% of total assets to total borrowings, as required by the Investment Company Act of 1940, as amended, while these notes are outstanding. As of March 31, 2008, and December 31, 2007, the Company was in compliance with these covenants.

Note 5. Guarantees and Commitments

In the ordinary course of business, the Company has issued guarantees and has extended standby letters of credit through financial intermediaries on behalf of certain portfolio companies. All standby letters of credit have been issued through Bank of America, N.A. As of March 31, 2008, and December 31, 2007, the Company had issued guarantees of debt and rental obligations aggregating $394.0 million and $270.6 million, respectively, and had extended standby letters of credit aggregating $96.3 million and $58.5 million, respectively. Under these arrangements, the Company would be required to make payments to third-party beneficiaries if the portfolio companies were to default on their related

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 5. Guarantees and Commitments, continued

payment obligations. The maximum amount of potential future payments was $490.3 million and $329.1 million at March 31, 2008, and December 31, 2007, respectively.

As of March 31, 2008, the guarantees and standby letters of credit expired as follows:

(in millions)	Total	2008	2009	2010	2011	2012	After 2012
Guarantees	$ 394.0	$ 0.3	$ 387.3	$	$ 4.4	$ 0.1	$ 1.9
Standby letters of credit[1]	96.3	96.3					
Total[2]	$ 490.3	$ 96.6	$ 387.3	$	$ 4.4	$ 0.1	$ 1.9

(1) Standby letters of credit are issued under the Company s revolving line of credit that expires in September 2008. Therefore, unless a standby letter of credit is set to expire at an earlier date, it is assumed that the standby letters of credit will expire contemporaneously with the expiration of the Company s line of credit that was in effect at March 31, 2008, which was scheduled to expire in September 2008. In April 2008, the Company entered into a new three-year revolving line of credit that expires in April 2011.

(2) The Company s most significant commitments relate to its investment in Ciena Capital LLC (Ciena), which commitments totaled $444.3 million at March 31, 2008. At March 31, 2008, the Company guaranteed 100% of the outstanding total obligations on Ciena s revolving line of credit, which matures in March 2009, for a total guaranteed amount of $384.8 million and had standby letters of credit issued totaling $59.5 million in connection with term securitizations completed by Ciena. See Note 3.

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

At March 31, 2008, the Company had outstanding commitments to fund investments totaling $885.3 million, including $845.3 million related to private finance investments and $40.0 million related to commercial real estate finance investments. Total outstanding commitments related to private finance investments included $493.5 million to the Unitranche Fund LLC, which the Company estimates will be funded over a two to three year period as investments are funded by the Unitranche Fund. See Note 3.

Note 6. Shareholders Equity

Sales of common stock for the three months ended March 31, 2008 and 2007, were as follows:

(in millions)	2008	2007
Number of common shares	8.3	3.3
Gross proceeds	$ 175.5	$ 97.3
Less costs, including underwriting fees	4.6	3.5
Net proceeds	$ 170.9	$ 93.8

In addition, in April 2008, the Company sold 3.2 million shares of its common stock for proceeds of $56.3 million, net of underwriting discounts and estimated offering expenses.

There were no stock options exercised during the three months ended March 31, 2008. The Company issued 0.1 million shares of common stock upon the exercise of stock options during the three months ended March 31, 2007.

The Company has a dividend reinvestment plan, whereby the Company may buy shares of its common stock in the open market or issue new shares in order to satisfy dividend reinvestment requests. If the Company issues new shares, the issue price is equal to the average of the closing sale prices reported for the Company s common stock for the five consecutive trading days immediately prior to the dividend

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 6. Shareholders Equity, continued

payment date. For the three months ended March 31, 2008 and 2007, the Company issued new shares in order to satisfy dividend reinvestment requests. Dividend reinvestment plan activity for the three months ended March 31, 2008 and 2007, was as follows:

	For the Three Months Ended March 31,	
	2008	2007
(in millions, except per share amounts)		
Shares issued	0.2	0.1
Average price per share	$ 19.49	$ 29.23

Note 7. Earnings Per Common Share

Earnings per common share for the three months ended March 31, 2008 and 2007, were as follows:

	For the Three Months Ended March 31,	
	2008	2007
(in millions, except per share amounts)		
Net increase (decrease) in net assets resulting from operations	$ (40.7)	$ 133.1
Weighted average common shares outstanding basic	161.5	149.5
Dilutive options outstanding		3.3
Weighted average common shares outstanding diluted	161.5	152.8
Basic earnings (loss) per common share	$ (0.25)	$ 0.89
Diluted earnings (loss) per common share	$ (0.25)	$ 0.87

Note 8. Employee Compensation Plans

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

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

The Company has an Individual Performance Award (IPA), which is generally determined annually at the beginning of each year but may be adjusted throughout the year. Through December 31, 2007, the IPA was deposited in a deferred compensation trust in four equal installments, generally on a

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 8. Employee Compensation Plans, continued

quarterly basis, in the form of cash. The Compensation Committee of the Board of Directors designed the trust to require the trustee to use the cash to purchase shares of the Company s common stock in the open market.

Through December 31, 2007, the IPA amounts were contributed into the trust and invested in the Company s common stock. The accounts of the trust were consolidated with the Company s accounts. The common stock was classified as common stock held in deferred compensation trust in the accompanying financial statements and the deferred compensation obligation, which represented the amount owed to the employees, was included in other liabilities. Changes in the value of the Company s common stock held in the deferred compensation trust were not recognized. However, the liability was marked to market with a corresponding charge or credit to employee compensation expense. On March 18, 2008, prior to the distribution of the assets held in the trust, the Company was required to record a final mark to market of the liability with a corresponding credit to employee compensation expense.

For 2008, the Compensation Committee has determined that the IPAs will be paid in cash in two equal installments during the year to eligible officers as long as the recipient remains employed by the Company, rather than contributed to a deferred compensation plan and invested in shares of the Company s common stock.

The IPA expense for the three months ended March 31, 2008 and 2007, was as follows:

($ in millions)	2008	2007
IPA	$ 2.4	$ 2.5
IPA mark to market expense (benefit)	(4.1)	(4.0)
Total IPA expense (benefit)	$ (1.7)	$ (1.5)

The Company also has an individual performance bonus (IPB), which is distributed in cash to award recipients equally throughout the year (beginning in February of each year) as long as the recipient remains employed by the Company. If a recipient terminates employment during the year, any remaining cash payments under the IPB would be forfeited. For the three months ended March 31, 2008 and 2007, the IPB expense was $1.7 million and $2.0 million, respectively. The IPA and IPB expenses are included in employee expenses.

Note 9. Stock Option Plan

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

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

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 9. Stock Option Plan, continued

At March 31, 2008, and December 31, 2007, there were 37.2 million shares authorized under the Option Plan and the number of shares available to be granted under the Option Plan was 3.9 million and 10.7 million, respectively.

Information with respect to options granted, exercised and forfeited under the Option Plan for the three months ended March 31, 2008, was as follows:

(in millions, except per share amounts)	Shares	Weighted Average Exercise Price Per Share	Weighted Average Contractual Remaining Term (Years)	Aggregate Intrinsic Value at March 31, 2008[1]
Options outstanding at January 1, 2008	18.5	$ 28.36		
Granted	7.1	$ 22.96		
Exercised		$		
Forfeited	(0.3)	$ 27.46		
Options outstanding at March 31, 2008	25.3	$ 26.86	6.35	$
Exercisable at March 31, 2008[2]	11.7	$ 27.99	6.13	$
Exercisable and expected to be exercisable at March 31, 2008[3]	23.5	$ 27.02	6.33	$

(1) Represents the difference between the market value of the options at March 31, 2008, and the cost for the option holders to exercise the options.

(2) Represents vested options.

(3) The amount of options expected to be exercisable at March 31, 2008, is calculated based on an estimate of expected forfeitures.

During the three months ended March 31, 2007, no options were granted, 0.1 million options were exercised and 0.3 million options were forfeited.

There were no shares vested during the three months ended March 31, 2008 and 2007. The total intrinsic value of the options exercised during the three months ended March 31, 2007, was $0.9 million. There were no options exercised during the three months ended March 31, 2008.

Note 10. Dividends and Distributions and Taxes

The Company s Board of Directors declared and the Company paid a dividend of $0.65 per common share and $0.63 per common share for the first quarters of 2008 and 2007, respectively. These dividends totaled $108.1 million and $95.8 million for the three months ended March 31, 2008 and 2007, respectively. The Company declared an extra cash dividend of $0.05 per share during 2006, which was paid to shareholders on January 19, 2007.

The Company s Board of Directors also declared a dividend of $0.65 per common share for the second quarter of 2008.

At December 31, 2007, the Company had estimated excess taxable income of $403.1 million available for distribution to shareholders in 2008. Estimated excess taxable income for 2007 represents approximately $50.0 million of ordinary income and approximately $353.1 million of net long-term capital gains.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 10. Dividends and Distributions and Taxes, continued

Dividends for 2008 will first be paid out of the excess taxable income carried over from 2007. Given the regular quarterly dividend payout, which for the first quarter of 2008 was $108.1 million, the Company expects that a majority of the 2008 dividend payments will be made from excess 2007 taxable earnings. The Company currently expects that the excess taxable income carried over from 2007 plus its estimated annual taxable income for 2008 will be in excess of its estimated dividend distributions to shareholders in 2008, therefore, the Company expects to carry over excess taxable income earned in 2008 for distribution to shareholders in 2009. The Company will generally be required to pay a nondeductible 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 for the year. The Company has accrued an excise tax on the estimated excess taxable income earned for the respective periods. For the three months ended March 31, 2008 and 2007, the Company recorded an excise tax of $2.3 million and $3.6 million, respectively.

In addition to excess taxable income carried forward, the Company currently estimates that it has cumulative deferred taxable income related to installment sale gains of approximately $234.5 million as of December 31, 2007, which is composed of cumulative deferred taxable income of $211.5 million as of December 31, 2006, and approximately $23.0 million for the year ended December 31, 2007. These gains have been recognized for financial reporting purposes in the respective years they were realized, but are generally deferred for tax purposes until the notes or other amounts received from the sale of the related investments are collected in cash.

The excess taxable income carried forward from 2007 and the realized gains deferred through installment treatment for 2007 are estimates and will not be finally determined until the Company files its 2007 tax return in September 2008.

The Company s undistributed book earnings of $535.9 million as of December 31, 2007, resulted from undistributed ordinary income and long-term capital gains. The difference between undistributed book earnings at the end of the year and taxable income carried over from the current year into the next year relates to a variety of timing and permanent differences in the recognition of income and expenses for book and tax purposes.

The Company s consolidated subsidiary, AC Corp, is subject to federal and state income taxes. For the three months ended March 31, 2008 and 2007, AC Corp s income tax benefit was $0.3 million and $4.2 million, respectively.

Note 11. Supplemental Disclosure of Cash Flow Information

The Company paid interest of $31.1 million and $24.9 million, respectively, for the three months ended March 31, 2008 and 2007.

Non-cash operating activities for the three months ended March 31, 2008 and 2007, totaled $132.0 million and $3.1 million, respectively. Non-cash operating activity for the three months ended March 31, 2008, included the exchange of existing debt securities and accrued interest with a cost basis of $99.6 million for new debt and equity securities and consideration received in connection with the sale of securities of $32.4 million, which was received in cash in April 2008.

Non-cash financing activities included the issuance of common stock in lieu of cash distributions totaling $3.8 million and $4.3 million, for the three months ended March 31, 2008 and 2007, respectively.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 12. Financial Highlights

	At and for the Three Months Ended March 31, 2008[1]	At and for the Three Months Ended March 31, 2007	At and for the Year Ended December 31, 2007
Per Common Share Data			
Net asset value, beginning of period	$ 17.54	$ 19.12	$ 19.12
Net investment income[2]	0.43	0.26	0.91
Net realized gains[2][3]	0.02	0.18	1.74
Net investment income plus net realized gains[2]	0.45	0.44	2.65
Net change in unrealized appreciation or depreciation [2][3]	(0.70)	0.43	(1.66)
Net increase (decrease) in net assets resulting from operations[2]	(0.25)	0.87	0.99
Net decrease in net assets from shareholder distributions	(0.65)	(0.63)	(2.64)
Net increase in net assets from capital share transactions [2][4]	0.35	0.22	0.41
Decrease in net assets from cash portion of the option cancellation payment[2][6]			(0.34)
Net asset value, end of period	$ 16.99	$ 19.58	$ 17.54
Market value, end of period	$ 18.43	$ 28.81	$ 21.50
Total return[5]	(11.4)%	(9.9)%	(27.6)%
Ratios and Supplemental Data			
($ and shares in thousands, except per share amounts)			
Ending net assets	$ 2,828.4	$ 2,978.3	$ 2,771.8
Common shares outstanding at end of period	166.5	152.1	158.0
Diluted weighted average common shares outstanding	161.5	152.8	154.7
Employee, employee stock option and administrative expenses/average net assets[7]	1.28%	1.33%	6.10%
Total operating expenses/average net assets[7]	2.62%	2.37%	10.70%
Income tax expense (benefit), including excise tax/average net assets[7]	0.07%	(0.02)%	0.47%
Net investment income/average net assets[7]	2.48%	1.36%	4.91%
Net increase (decrease) in net assets resulting from operations/average net assets[7]	(1.45)%	4.57%	5.34%
Portfolio turnover rate[7]	5.62%	3.78%	26.84%
Average debt outstanding	$ 2,209.5	$ 1,841.2	$ 1,924.2
Average debt per share[2]	$ 13.68	$ 12.05	$ 12.44

(1) The results for the three months ended March 31, 2008, are not necessarily indicative of the operating results to be expected for the full year.

(2) Based on diluted weighted average number of common shares outstanding for the period.

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

(4) Excludes capital share transactions related to the cash portion of the option cancellation payment.

(5) Total return assumes the reinvestment of all dividends paid for the periods presented.

(6) On July 18, 2007, the Company completed a tender offer, which resulted in a total option cancellation payment of approximately $105.6 million, of which $52.8 million was paid in cash and $52.8 million was paid through the issuance of unregistered shares of the Company s common stock.

(7) The ratios for the three months ended March 31, 2008 and 2007, do not represent annualized results.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 13. Litigation

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

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

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

On February 13, 2007, Rena Nadoff filed a shareholder derivative action in the Superior Court of the District of Columbia, captioned Rena Nadoff v. Walton, et al., CA 001060-07, seeking unspecified compensatory and other damages, as well as equitable relief on behalf of Allied Capital Corporation. The complaint was summarily dismissed in July 2007. The complaint alleged breach of fiduciary duty by the Board of Directors arising from internal control failures and mismanagement of Business Loan Express, LLC, an Allied Capital portfolio company. On October 5, 2007, Rena Nadoff sent a letter to the Company s Board of Directors with substantially the same claims and a request that the Board of Directors investigate the claims and take appropriate action. The Board of Directors has established a committee, which is advised by its own counsel, to review the matter.

On February 26, 2007, Dana Ross filed a class action complaint in the U.S. District Court for the District of Columbia in which she alleges that Allied Capital Corporation and certain members of management violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. Thereafter, the court appointed new lead counsel and approved new lead plaintiffs. On July 30,

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 13. Litigation, continued

2007, plaintiffs served an amended complaint. Plaintiffs claim that, between November 7, 2005, and January 22, 2007, Allied Capital either failed to disclose or misrepresented information about its portfolio company, Business Loan Express, LLC. Plaintiffs seek unspecified compensatory and other damages, as well as other relief. The Company believes the lawsuit is without merit, and intends to defend the lawsuit vigorously. On September 13, 2007, the Company filed a motion to dismiss the lawsuit. The motion is pending.

In addition, the Company is party to certain lawsuits in the normal course of business.

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

Schedule 12-14

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
SCHEDULE OF INVESTMENTS IN AND ADVANCES TO AFFILIATES

PRIVATE FINANCE **Portfolio Company** **(in thousands)**	**Investment**[1]	**Amount of Interest or Dividends** **Credited to Income**[6]	**Other**[2]	**December 31, 2007 Value**	**Gross Additions**[3]	**Gross Reductions**[4]	**March 31, 2008 Value**
Companies More Than 25% Owned							
AGILE Fund I, LLC	Equity Interests			$	$ 860	$	$ 860
(Private Equity Fund)							
Alaris Consulting, LLC	Senior Loan[5]						
(Business Services)	Equity Interests				1,211	(1,211)	
AllBridge Financial, LLC	Equity Interests			7,800	13,944	(6,274)	15,470
(Asset Management)							
Allied Capital Senior Debt Fund, L.P.	Equity Interests			32,811		(206)	32,605
(Private Debt Fund)							
Avborne, Inc.	Preferred Stock			1,633	51		1,684
(Business Services)	Common Stock						
Avborne Heavy Maintenance, Inc.	Preferred Stock			2,557		(2,400)	157
(Business Services)	Common Stock			370	667		1,037
Aviation Properties Corporation	Common Stock						
(Business Services)							
Border Foods, Inc.	Preferred Stock			4,648		(1,507)	3,141

(Consumer Products)	Common Stock						
Calder Capital Partners, LLC	Senior Loan(5)		$ 65	3,035	540	(502)	3,073
(Asset Management)	Equity Interests			3,559		(25)	3,534
Callidus Capital Corporation	Senior Loan	$ 4			1,500		1,500
(Asset Management)	Subordinated Debt	348		6,871	4,309		11,180
	Common Stock	3,000		44,587		(4,565)	40,022
Ciena Capital LLC	Class A Equity						
(f/k/a Business Loan	Interests(5)			68,609		(39,318)	29,291
Express, LLC)	Class B Equity Interests						
(Financial Services)	Class C Equity Interests						
CitiPostal Inc.	Senior Loan	13		679	1		680
(Business Services)	Unitranche Debt	1,561		50,597	529		51,126
	Subordinated Debt	327		8,049	43		8,092
	Common Stock			12,726	4,051		16,777
Coverall North America, Inc.	Unitranche Debt	1,013		34,923	19	(3,019)	31,923
(Business Services)	Subordinated Debt	216		5,979	3	(437)	5,545
	Common Stock			27,597	2,698	(2,287)	28,008
CR Holding, Inc.	Subordinated Debt	1,645		40,812	374	(3,006)	38,180
(Consumer Products)	Common Stock			40,934		(13,452)	27,482
Crescent Equity Corp.	Senior Loan	11		433			433
(Business Services/	Subordinated Debt	892		42,977	488	(12,486)	30,979
Broadcasting & Cable)	Subordinated Debt(5)			1,583	100		1,683
		36		83,453	5,622	(64,762)	24,313

	Common Stock

See related footnotes at the end of this schedule.

PRIVATE FINANCE Portfolio Company (in thousands)	Investment[1]	Amount of Interest or Dividends Credited to Income[6]	Other[2]	December 31, 2007 Value	Gross Additions[3]	Gross Reductions[4]	March 31, 2008 Value
Direct Capital Corporation	Subordinated Debt	1,661		39,030	13,641	(2,965)	49,706
(Financial Services)	Common Stock			6,906	6,744	(2,644)	11,006
Financial Pacific Company	Subordinated Debt	3,027		72,850	362	(5,314)	67,898
(Financial Services)	Preferred Stock	1,281		19,330		(1,779)	17,551
	Common Stock			38,544		(14,523)	24,021
ForeSite Towers, LLC	Equity Interest			878		(75)	803
(Tower Leasing)							
Global Communications, LLC	Senior Loan[5]			1,822		(472)	1,350
(Business Services)							
Hot Light Brands, Inc.	Senior Loan[5]				29,628		29,628
(Retail)	Common Stock				5,151	(4,001)	1,150
Hot Stuff Foods, LLC	Senior Loan	$ 956		$ 50,752	$ 1,596	$ (110)	$ 52,238
(Consumer Products)	Subordinated Debt	826		29,907	545	(10,053)	20,399
	Subordinated Debt[5]			1,337		(1,337)	
	Common Stock						
Huddle House, Inc.	Subordinated Debt	2,165		59,618	454	(4,355)	55,717
(Retail)	Common Stock			44,154		(7,330)	36,824
Impact Innovations Group, LLC	Equity Interests in						

(Business Services)	Affiliate		320	1		321
Insight Pharmaceuticals	Subordinated Debt	2,633	45,041	1,304	(904)	45,441
Corporation	Subordinated Debt[5]		16,796	171		16,967
(Consumer Products)	Preferred Stock		1,462	9,099		10,561
	Common Stock					
Jakel, Inc.	Subordinated Debt[5]		1,563		(815)	748
(Industrial Products)						
Legacy Partners Group, Inc.	Senior Loan[5]		3,843		(3,000)	843
(Business Services)	Equity Interests		1,332		(187)	1,145
Litterer Beteiligungs-GmbH	Subordinated Debt	16	772	56		828
(Business Services)	Equity Interest		700	150		850
MHF Logistical Solutions, Inc.[7]	Subordinated Debt[5]			14,310	(4,991)	9,319
(Business Services)	Preferred Stock					
	Common Stock					
MVL Group, Inc.	Senior Loan	922	30,639	6		30,645
(Business Services)	Subordinated Debt	1,518	39,943	296		40,239
	Common Stock		4,949		(576)	4,373
Old Orchard Brands, LLC	Subordinated Debt	838	19,544	209	(1,428)	18,325
(Consumer Products)	Equity Interests		25,419	2,793	(2,910)	25,302
Penn Detroit Diesel Allison, LLC	Subordinated Debt	1,457	39,180	714	(2,883)	37,011
(Business Services)	Equity Interests		37,965		(4,443)	33,522
Powell Plant Farms, Inc.	Senior Loan		1,534		(1,534)	
(Consumer Products)						

Service Champ, Inc.	Subordinated Debt	1,086	28,351	193	(2,083)	26,461
(Business Services)	Common Stock		26,292		(2,541)	23,751
Staffing Partners Holding Company, Inc. (Business Services)	Subordinated Debt		223	286	(509)	
Startec Equity, LLC (Telecommunications)	Equity Interests		430		(33)	397
Sweet Traditions, Inc. (Retail)	Senior Loan(5)		35,229	4,597	(39,399)	427
	Preferred Stock			950	(950)	
	Common Stock			50	(50)	
Unitranche Fund LLC	Subordinated Certificates	274	744	30,747		31,491
(Private Debt Fund)	Equity Interests		1			1
Worldwide Express Operations, LLC (Business Services)	Subordinated Debt	102	2,670	81	(212)	2,539
	Equity Interests	796	21,516		(2,852)	18,664
	Warrants		272		(36)	236

See related footnotes at the end of this schedule.

PRIVATE FINANCE Portfolio Company (in thousands)	Investment[1]	Amount of Interest or Dividends Credited to Income[6]	Other[2]	December 31, 2007 Value	Gross Additions[3]	Gross Reductions[4]	March 31, 2008 Value
Total companies more than 25% owned		**$ 28,624**		**$ 1,279,080**			**$ 1,157,473**
Companies 5% to 25% Owned							
10th Street, LLC	Subordinated Debt	$ 680		$ 20,645	$ 129		$ 20,774
(Business Services)	Equity Interests			1,100		(25)	1,075
	Option				25		25
Advantage Sales & Marketing, Inc.	Subordinated Debt	4,738		154,854	2,589		157,443
(Business Services)	Equity Interests			10,973		(773)	10,200
Air Medical Group Holdings LLC	Senior Loan	63		2,980	3,217	(2,332)	3,865
(Healthcare Services)	Equity Interests	1,011		10,800		(900)	9,900
Alpine ESP Holdings, Inc.	Preferred Stock	19		749		(127)	622
(Business Services)	Common Stock			262		(262)	
Amerex Group, LLC	Subordinated Debt	241		8,400		(611)	7,789
(Consumer Products)	Equity Interests	2,349		13,713		(941)	12,772
BB&T Capital Partners/ Windsor Mezzanine Fund, LLC	Equity Interests			11,467	8		11,475

(Private Equity Fund)						
Becker Underwood, Inc.	Subordinated Debt	$ 921	$ 24,798	$ 726	$	$ 25,524
(Industrial Products)	Common Stock		4,190	609	(799)	4,000
BI Incorporated	Subordinated Debt	1,049	30,499	422		30,921
(Business Services)	Common Stock		7,382		(1,182)	6,200
Creative Group, Inc.	Subordinated Debt[5]		6,197		(1,012)	5,185
(Business Services)	Common Stock Warrant					
Drew Foam Companies, Inc.	Preferred Stock		396		(126)	270
(Business Services)	Common Stock			1	(1)	
Hilden America, Inc.	Common Stock			454	(9)	445
(Consumer Products)						
MedBridge Healthcare, LLC	Senior Loan[5]		7,164			7,164
(Healthcare Services)	Subordinated Debt[5]		2,406	195		2,601
	Convertible Subordinated Debt[5]					
	Equity Interests					
MHF Logistical Solutions, Inc.	Subordinated Debt		9,280		(9,280)	
(Business Services)	Common Stock Warrants					
Multi-Ad Services, Inc.	Unitranche Debt	568	19,704	78	(50)	19,732
(Business Services)	Equity Interests		940	348	(274)	1,014

Progressive International Corporation (Consumer Products)	Subordinated Debt	65	1,545	31		1,576
	Preferred Stock		1,038	21		1,059
	Common Stock		4,900	900		5,800
	Warrants					
Regency Healthcare Group, LLC	Senior Loan	1				
(Healthcare Services)	Unitranche Debt	340	11,941	356		12,297
	Equity Interests	25	1,681	22	(206)	1,497
SGT India Private Limited (Business Services)	Common Stock		3,075		(495)	2,580
Soteria Imaging Services, LLC	Subordinated Debt	530	13,744	2,006		15,750
(Healthcare Services)	Equity Interests	74	2,686		(483)	2,203
Universal Environmental Services, LLC (Business Services)	Equity Interests			249	(249)	
Total companies 5% to 25% owned		**$ 12,674**	**$ 389,509**			**$ 381,758**

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

(1) Common stock, preferred stock, warrants, options, and equity interests are generally non-income producing and restricted. The principal amount for loans and debt securities and the number of shares of common stock and preferred stock is shown in the consolidated statement of investments as of March 31, 2008.

(2) Other includes interest, dividend, or other income which was applied to the principal of the investment and therefore reduced the total investment. These reductions are also included in the Gross Reductions for the investment, as applicable.

(3) Gross additions include increases in the cost basis of investments resulting from new portfolio investments, paid-in-kind interest or dividends, the amortization of discounts and closing fees, the exchange of one or more existing securities for one or more new securities and the movement of an existing portfolio company into this category from a different category. Gross additions also include net increases in unrealized appreciation or net decreases in unrealized depreciation.

(4) Gross reductions include decreases in the cost basis of investments resulting from principal collections related to investment repayments or sales, the exchange of one or more existing securities for one or more new securities and the movement of an existing portfolio company out of this category into a different category. Gross reductions also include net increases in unrealized depreciation or net decreases in unrealized appreciation.

(5) Loan or debt security is on non-accrual status at March 31, 2008, and is therefore considered non-income producing. Loans or debt securities on non-accrual status at the end of the period may or may not have been on non-accrual status for the full period.

(6) Represents the total amount of interest or dividends credited to income for the portion of the year an investment was included in the companies more than 25% owned or companies 5% to 25% owned categories, respectively.

(7) In the first quarter of 2008, the Company exercised its option to acquire a majority of the voting securities of MHF Logistical Solutions, Inc. (MHF). Therefore, MHF was reclassified to companies more than 25% owned in the first quarter of 2008. At December 31, 2007, the Company s investment in MHF was included in the companies 5% to 25% owned category.

7,500,000 Shares
Common Stock

Prospectus Supplement
May , 2008

Morgan Stanley **Citi** **Deutsche Bank Securities** **Merrill Lynch & Co.**
BB&T Capital Markets
a division of Scott & Stringfellow, Inc.
Davenport & Company LLC
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