ALLIED CAPITAL CORP
Form 497
October 21, 2002

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Registration Statement No. 333-98441

PROSPECTUS

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

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

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

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

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

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

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

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

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

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

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

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

October 21, 2002

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

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PROSPECTUS SUMMARY

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

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

BUSINESS *(Page 69)*

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

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

Our investment portfolio generally includes:

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

We identify loans and investments through our numerous relationships with:

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

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

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

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

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

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

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

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

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

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

VALUATION OF PORTFOLIO INVESTMENTS *(Page 91)*

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

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

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

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

THE RIGHTS OFFERING *(Page 19)*

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

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

INFORMATION AGENT

The information agent for the rights offering is:

Georgeson Shareholder Communications, Inc.

Toll-free: (866) 206-4938

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

IMPORTANT DATES TO REMEMBER

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

* Unless the rights offering is extended.

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

USE OF PROCEEDS *(Page 29)*

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

DISTRIBUTIONS *(Page 30)*

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

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

DIVIDEND REINVESTMENT PLAN *(Page 116)*

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

RISK FACTORS *(Page 12)*

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

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

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

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

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

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

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

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

CERTAIN ANTI-TAKEOVER PROVISIONS *(Page 118)*

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

LEGAL PROCEEDINGS *(Page 82)*

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

FEES AND EXPENSES

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

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

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

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

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

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

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

Example

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

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

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

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

may be greater or less than those shown.

SELECTED CONDENSED CONSOLIDATED FINANCIAL DATA

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

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

Expenses:

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

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

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

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

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

Per Share:

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

	At June 30,	At December 31,				
(in thousands, except per share data)	**2002**	**2001**	**2000**	**1999**	**1998**	**1997**