

ALLIED CAPITAL CORP
Form N-2
May 03, 2006

As filed with the Securities and Exchange Commission on May 3, 2006

Registration No. 333-

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM N-2
REGISTRATION STATEMENT
UNDER

THE SECURITIES ACT OF 1933

Pre-Effective Amendment No.

Post-Effective Amendment No.

ALLIED CAPITAL CORPORATION

(Exact Name of Registrant as Specified in Charter)

1919 Pennsylvania Avenue, N.W.

Washington, D.C. 20006-3434

(202) 721-6100

(Address and Telephone Number, including Area Code, of Principal Executive Offices)

William L. Walton, Chairman and Chief Executive Officer

Allied Capital Corporation

1919 Pennsylvania Avenue, N.W.

Washington, D.C. 20006-3434

(Name and Address of Agent for Service)

Copies of information to:

Steven B. Boehm, Esq.

Cynthia M. Krus, Esq.

Sutherland Asbill & Brennan LLP

1275 Pennsylvania Avenue, N.W.

Washington, D.C. 20004-2415

Approximate Date of Proposed Public Offering:

From time to time after the effective date of the Registration Statement.

If any securities being registered on this form will be offered on a delayed or continuous basis in reliance on Rule 415 under the Securities Act of 1933, other than securities offered in connection with a dividend reinvestment plan, check the following box. x

CALCULATION OF REGISTRATION FEE UNDER THE SECURITIES ACT OF 1933

Title of Securities Being Registered	Amount Being Registered	Proposed Maximum Aggregate Principal Amount ⁽¹⁾	Amount of Registration Fee
Debt Securities	\$500,000,000	\$500,000,000	\$53,500

(1) Estimated solely for the purpose of computing the registration fee pursuant to Rule 457(o) of the Securities Act of 1933, as amended.

The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933, as amended, or until this registration statement shall become effective on such date as the Commission, acting pursuant to Section 8(a), may determine.

The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

**PROSPECTUS (SUBJECT TO COMPLETION)
ISSUED , 2006**

**\$500,000,000
Debt Securities**

We may offer, from time to time, up to an aggregate principal amount of \$500,000,000 of one or more classes or series of debt securities in one or more offerings.

The debt securities may be offered at prices and on terms to be described in one or more supplements to this prospectus.

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, the accompanying prospectus supplement, if any, and the pricing supplement, if any, before investing in our debt securities and keep it for future reference. The prospectus contains and the accompanying prospectus supplement, if any, and the pricing supplement, if any, will contain important information about us that a prospective investor should know before investing in our debt securities. 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, NW, 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.

You should review the information set forth under Risk Factors on page 9 of this prospectus before investing in our debt securities.

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 our debt securities unless accompanied by a prospectus supplement and, if applicable, a pricing supplement.

, 2006

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 any prospectus supplement, if any, or any pricing 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, we may offer, from time to time, up to \$500,000,000 in aggregate principal amount of debt securities on the terms to be determined at the time of the

offering. The debt securities 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 debt securities we may offer. Each time we use this prospectus to offer debt securities, we will provide a prospectus supplement and, if applicable, a pricing supplement that will contain specific information about the terms of that offering. 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 and, if applicable, a pricing supplement may also add to, update or change information contained in this prospectus.

(i)

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

BUSINESS (Page 59)

We are a business development company and we are in the private equity business. 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 and have financed 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. Our private finance portfolio includes investments in over 100 companies with aggregate annual revenue of over \$10 billion and employ more than 85,000 people.

We generally target companies in less cyclical industries in the middle market with, among other things, high return on invested capital, management teams with meaningful equity ownership, well-constructed balance sheets, and the ability to generate free cash flow. 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 (a single debt investment that is a blend of senior and subordinated debt), 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 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 structure our investments to generate income from management, consulting, diligence, structuring, or other fees. We may also enhance our total return from capital gains through equity features, such as nominal cost warrants, or by investing in equity investments.

We provide managerial assistance to our portfolio companies, including 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 elected to be taxed as a regulated investment company under the Internal Revenue Code of 1986, as amended, which we refer to as the Code. Our status as a regulated investment company generally eliminates a corporate-level income tax on taxable income we timely distribute to our stockholders as dividends, if certain requirements are met. See Tax Status. We determine our regular quarterly dividends considering our estimate of annual taxable income available for distribution. Since 1963, our portfolio has generally provided sufficient ordinary taxable income and 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, NW, Washington, DC, 20006 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 83)**

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 pursuant to our valuation policy and 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. Instead we are required 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 or when the enterprise value of the company does not currently support the cost of our debt or equity investment. Enterprise value means the entire value of the company to a potential buyer including the sum of the values of all debt and equity securities used to capitalize the enterprise at a point in time. Conversely, we will record unrealized appreciation if we believe that the underlying portfolio company has appreciated in value and/or our equity security has appreciated in value. Without a readily available 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 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 134)*

We may offer, from time to time, up to \$500,000,000 aggregate principal amount of debt securities, on terms to be determined at the time of the offering.

Our debt securities may be offered at prices and on terms described in one or more supplements to this prospectus. Our debt securities 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 supplements to this prospectus relating to any offering of debt securities will identify any agents or underwriters involved in the sale of our debt securities, and will set forth any applicable purchase price, fee and commission or discount arrangement or the basis upon which such amount may be calculated.

We may not sell debt securities pursuant to this prospectus without delivering a prospectus supplement and, if applicable, a pricing supplement describing the method and terms of the offering of such debt securities.

USE OF PROCEEDS *(Page 19)*

We intend to use the net proceeds from selling debt securities 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.

The supplements to this prospectus relating to any offering of debt securities will more fully identify the use of proceeds from such offering.

RISK FACTORS *(Page 9)*

Investment in our debt securities involves a number of significant risks relating to our business and our investment objective that you should consider before investing in our debt securities.

Our portfolio of investments is generally illiquid. 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 engage in a liquidity event, which is a transaction that involves the sale or recapitalization of all or part of a portfolio company. 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 and distributions to our shareholders, which may have a material adverse effect on our total return to common shareholders, if any.

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

The market value of our debt securities may be volatile due to market factors that may be beyond our control.

RATIOS OF EARNINGS TO FIXED CHARGES (Page 17)

Our ratio of earnings to fixed charges for the five years ended December 31, 2005 was 12.4, 4.3, 3.4, 4.2 and 4.0, respectively. For more information, see the section entitled "Ratios of Earnings to Fixed Charges" in this prospectus.

SENIOR SECURITIES (Page 55)

At December 31, 2005, we had \$1.3 billion of outstanding indebtedness bearing a weighted average annual interest cost of 6.5%. If our portfolio fails to produce adequate returns, we may be unable to make interest or principal payments on our indebtedness when they are due, which could give rise to a default on and acceleration of our indebtedness. In order for us to cover annual interest payments on indebtedness, we must achieve annual returns on our assets of at least 2.1% as of December 31, 2005.

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, 2005, 2004, 2003, and 2002, has been derived from our financial statements that were audited by KPMG LLP. Financial information at and for the year ended December 31, 2001, 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. See **Management's Discussion and Analysis of Financial Condition and Results of Operations** below for more information.

	Year Ended December 31,				
(in thousands, except per share data)	2005	2004	2003	2002	2001
Operating Data:					
Interest and related portfolio income:					
Interest and dividends	\$317,153	\$319,642	\$290,719	\$264,042	\$240,464
Loan prepayment premiums	6,250	5,502	8,172	2,776	2,504
Fees and other income	50,749	41,946	30,338	43,110	46,142
 Total interest and related portfolio income	 374,152	 367,090	 329,229	 309,928	 289,110
Expenses:					
Interest	76,798	75,650	77,233	70,443	65,104
Employee	78,300	53,739	36,945	33,126	29,656
Administrative	70,267	34,686	22,387	21,504	15,299
 Total operating expenses	 225,365	 164,075	 136,565	 125,073	 110,059
Net investment income before income taxes	148,787	203,015	192,664	184,855	179,051
Income tax expense (benefit), including excise tax	11,561	2,057	(2,466)	930	(412)
Net investment income	137,226	200,958	195,130	183,925	179,463
Net realized and unrealized gains (losses):					
Net realized gains	273,496	117,240	75,347	44,937	661
Net change in unrealized appreciation or depreciation	462,092	(68,712)	(78,466)	(571)	20,603
 Total net gains (losses)	 735,588	 48,528	 (3,119)	 44,366	 21,264
Net increase in net assets resulting from operations	\$872,814	\$249,486	\$192,011	\$228,291	\$200,727
Per Share:					
Diluted earnings per common share	\$ 6.36	\$ 1.88	\$ 1.62	\$ 2.20	\$ 2.16

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Dividends per common share ⁽¹⁾	\$ 2.33	\$ 2.30	\$ 2.28	\$ 2.23	\$ 2.01
Weighted average common shares outstanding diluted	137,274	132,458	118,351	103,574	93,003

At December 31,

(in thousands, except per share data)	2005	2004	2003	2002	2001
Balance Sheet Data:					
Portfolio at value	\$3,606,355	\$3,013,411	\$2,584,599	\$2,488,167	\$2,329,590
Total assets	4,025,880	3,260,998	3,019,870	2,794,319	2,460,713
Total debt outstanding ⁽²⁾	1,284,790	1,176,568	954,200	998,450	1,020,806
Preferred stock issued to Small Business Administration ⁽²⁾			6,000	7,000	7,000
Shareholders' equity	2,620,546	1,979,778	1,914,577	1,546,071	1,352,123
Shareholders' equity per common share (net asset value) ⁽³⁾	\$ 19.17	\$ 14.87	\$ 14.94	\$ 14.22	\$ 13.57
Common shares outstanding at end of year	136,697	133,099	128,118	108,698	99,607
Asset coverage ratio ⁽⁴⁾	309%	280%	322%	270%	245%
Debt to equity ratio	0.49	0.59	0.50	0.65	0.75

Year Ended December 31,

	2005	2004	2003	2002	2001
Other Data:					
Investments funded	\$1,675,773	\$1,524,523	\$931,450	\$506,376	\$680,329
Principal collections related to investment repayments or sales	1,503,388	909,189	788,328	356,641	204,441
Realized gains	343,061	267,702	94,305	95,562	10,107
Realized losses	(69,565)	(150,462)	(18,958)	(50,625)	(9,446)

	2005				2004			
(in thousands, except per share data)	Qtr 4	Qtr 3	Qtr 2	Qtr 1	Qtr 4	Qtr 3	Qtr 2	Qtr 1
Quarterly Data (unaudited):								
Total interest and related portfolio income	\$ 98,169	\$ 94,857	\$ 86,207	\$ 94,919	\$100,962	\$96,863	\$87,500	\$81,765
Net investment income	37,073	46,134	15,267	38,752	54,678	52,745	48,990	44,545
Net increase in net assets resulting from operations	328,140	113,168	311,885	119,621	47,837	85,999	95,342	20,308
Diluted earnings per common share	\$ 2.36	\$ 0.82	\$ 2.29	\$ 0.88	\$ 0.35	\$ 0.66	\$ 0.73	\$ 0.15
Dividends declared per common share ⁽⁵⁾	0.61	0.58	0.57	0.57	0.59	0.57	0.57	0.57
Net asset value per common share ⁽³⁾	19.17	17.37	17.01	15.22	14.87	14.90	14.77	14.60

- (1) Dividends are based on taxable income, which differs from income for financial reporting purposes.
- (2) See *Senior Securities* for more information regarding our level of indebtedness.
- (3) 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.
- (4) As a business development company, we are generally required to maintain a minimum ratio of 200% of total assets to total borrowings.
- (5) Dividends declared per common share for the fourth quarter of 2004 included the regular quarterly dividend of \$0.57 per common share and an extra dividend of \$0.02 per common share. Dividends declared per common share for the fourth quarter of 2005 included the regular quarterly dividend of \$0.58 per common share and an extra dividend of \$0.03 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 debt securities being offered by this prospectus.

We file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission under the Securities Exchange Act of 1934. You can inspect any materials we file with the Securities and Exchange Commission, without charge, at the Securities and Exchange Commission's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Please call the Securities and Exchange Commission at 1-800-SEC-0330 for further information on the Public Reference Room. The Securities and Exchange Commission maintains a web site that contains reports, proxy statements and other information regarding registrants, including us, that file such information electronically with the Securities and Exchange Commission. The address of the Securities and Exchange Commission's web site is *www.sec.gov*. Information contained on the Securities and Exchange Commission's web site about us is not incorporated into this prospectus and you should not consider information contained on the Securities and Exchange Commission's web site 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 any collateral for the loan.

Substantially all of our portfolio investments are recorded at fair value as determined in good faith by our Board of Directors and, as a result, there is uncertainty regarding the value of our portfolio investments. At December 31, 2005, portfolio investments recorded at fair value were approximately 90% 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 readily available 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 on a quarterly basis 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, or when the enterprise value of the portfolio company does not currently support the cost of our debt or equity investment. 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. We will record unrealized appreciation if we believe that the underlying portfolio company has appreciated in value and/or our equity security has appreciated in value. Without a readily available 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. 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.

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 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 an effect on the valuations of private companies and on the potential for liquidity events involving such companies. This could affect the timing of exit events in our portfolio 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 primarily make long-term unsecured, subordinated loans and invest in equity securities, which may involve a higher degree of repayment risk. We primarily invest in companies that may have limited financial resources, 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 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 investments are typically structured as unsecured debt securities with a relatively high fixed rate of interest and with equity features such as conversion rights, warrants, or options, or as buyouts of companies where we invest in debt and equity securities. As a result, our private finance investments are generally structured to generate interest income from the time they are made and may also produce a realized gain from an accompanying equity feature. We cannot be sure that our portfolio will generate a current return or capital gains.

Our financial results could be negatively affected if 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 December 31, 2005, our largest investments at value were in Advantage Sales & Marketing, Inc. and Business Loan Express, LLC (BLX) and represented 16.4% and 8.9% of our total assets, respectively, and each individually represented 10.0% of our total interest and related portfolio income for the year ended December 31, 2005. BLX is a lender under the Small Business Administration 7(a) Guaranteed Loan Program. Our financial results could be negatively affected if government funding for, or regulations related to, this program change.

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. The debt securities we may issue pursuant to this prospectus, the prospectus supplement, and the applicable pricing supplement, if any, are a form of such borrowings. 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 shareholders will bear the cost associated with our leverage activity. Our revolving line of credit, notes payable and debentures contain financial and operating covenants that could restrict our business activities, including our ability to declare dividends if we default under certain provisions.

At December 31, 2005, we had \$1.3 billion of outstanding indebtedness bearing a weighted average annual interest cost of 6.5%. 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 2.1% as of December 31, 2005.

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) \$4,025.9 million in total assets, (ii) an average cost of funds of 6.5%, (iii) \$1,284.8 million in debt outstanding and (iv) \$2,620.5 million of shareholders equity.

	Assumed Return on Our Portfolio (net of expenses)						
	-20%	-10%	-5%	0%	5%	10%	20%
Corresponding return to shareholder	-33.66%	-18.29%	-10.61%	-2.93%	4.75%	12.43%	27.79%

We may not borrow money unless we maintain asset coverage for indebtedness of at least 200%, which may affect returns to shareholders. We must maintain asset coverage for total borrowings of at least 200%. Our ability to achieve our investment objective may depend in part on our continued ability to maintain a leveraged capital structure by borrowing from banks, 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 December 31, 2005, our asset coverage for senior indebtedness was 309%.

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 December 31, 2005, 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 less than 1% over a one year horizon. Although management believes that this measure is indicative of our sensitivity to interest rate changes, it does not adjust for potential changes in credit quality, size and composition of the assets on the balance sheet and other business developments that could affect net increase in 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 and have issued 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 taxable ordinary income, 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 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. We expect 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 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 shareholders because in certain cases we may recognize income before or without receiving cash representing such income. If we fail to qualify as a regulated investment company, we will have to pay corporate-level taxes on all of our income whether or not we distribute it, which would substantially reduce the amount of income available for 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 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.

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

Our ability to invest in private companies may be limited in certain circumstances. If we are 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. If we acquire debt or equity securities from an issuer that has outstanding marginable securities at the time we make an investment, these acquired assets cannot be treated as qualifying assets. This result is dictated by the definition of eligible portfolio company under the 1940 Act, which in part looks to whether a company has outstanding marginable securities.

Amendments promulgated in 1998 by the Federal Reserve expanded the definition of a marginable security under the Federal Reserve's margin rules to include any non-equity security. Thus, any debt securities issued by any entity are marginable securities under the Federal Reserve's current margin rules. As a result, the staff of the SEC has raised the question as to whether a private company that has outstanding debt securities would qualify as an eligible portfolio company under the 1940 Act.

Until the question raised by the staff of the SEC pertaining to the Federal Reserve's 1998 change to its margin rules has been addressed by legislative, administrative or judicial action, we intend to treat as qualifying assets only those debt and equity securities that are issued by a private company that has no marginable securities outstanding at the time we purchase such securities or those that otherwise qualify as an eligible portfolio company under the 1940 Act.

In November 2004, the SEC issued proposed rules to correct the unintended consequence of the Federal Reserve's 1998 margin rule amendments of apparently limiting the investment opportunities of business development companies. In general, the SEC's proposed rules would define an eligible portfolio company as any company that does not have securities listed on a national securities exchange or association. We currently do not believe that these proposed rules will have a material adverse effect on our operations.

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, variation 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. Upon issuance, our publicly issued debt securities will not have an established trading market. We cannot assure you 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.

You should also be aware that there may be a limited number of buyers when you decide to sell your debt securities. This too may materially adversely affect the market value of the debt securities or the trading market for the debt securities.

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

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.

RATIOS OF EARNINGS TO FIXED CHARGES

For the five years ended December 31, 2005, the ratios of earnings to fixed charges of the Company, computed as set forth below, were as follows:

	Year Ended December 31				
	2005	2004	2003	2002	2001
Earnings to Fixed Charges*	12.4	4.3	3.4	4.2	4.0

For purposes of computing the ratios of earnings to fixed charges, earnings represent net increase in net assets resulting from operations plus (or minus) income tax expense (benefit) plus excise tax expense plus fixed charges. Fixed charges include interest expense, a portion of rent expense and preferred stock dividend expense. We have assumed that one-third of the annual rent expense represents fixed charges.

* Earnings include the net change in unrealized appreciation or depreciation. Net change in unrealized appreciation or depreciation can vary substantially from year to year. Excluding the net change in unrealized appreciation or depreciation, the earnings to fixed charges ratio would be 5.3, 4.1, 3.5, 3.2 and 2.7 for the five years ended December 31, 2005, respectively.

Disclosure Regarding Forward-Looking Statements

Information contained or incorporated by reference in this prospectus and any prospectus supplement and pricing supplement, if any, 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 or other 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 and general economic conditions;

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

future changes in laws or regulations and conditions in our operating areas; 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 and pricing supplement, if any, 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 and pricing supplement, if any, 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.

USE OF PROCEEDS

We intend to use the net proceeds from selling debt securities 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 equity capital or issue debt as we deem appropriate to fund such new investments.

We anticipate that substantially all of the net proceeds of any offering of debt securities will be used as described above or in any prospectus supplement and pricing supplement, if any, accompanying this prospectus. Pending investment, we intend to invest the net proceeds of any offering of debt securities 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 of debt securities, 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 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 April , 2006, the last reported closing sale price of our common stock was \$ per share.

	NAV ⁽¹⁾	Closing Sales Price		Premium of High Sales Price to NAV ⁽²⁾	Premium of Low Sales Price to NAV ⁽²⁾	Declared Dividends
		High	Low			
<i>Year ending December 31, 2004</i>						
First Quarter	\$ 14.60	\$30.85	\$27.15	211%	186%	\$0.57
Second Quarter	\$ 14.77	\$30.25	\$23.06	205%	156%	\$0.57
Third Quarter	\$ 14.90	\$25.80	\$22.22	173%	149%	\$0.57
Fourth Quarter	\$ 14.87	\$28.47	\$24.46	191%	164%	\$0.57
Extra Dividend						\$0.02
<i>Year ended December 31, 2005</i>						
First Quarter	\$ 15.22	\$27.84	\$24.89	183%	164%	\$0.57
Second Quarter	\$ 17.01	\$29.29	\$25.83	172%	152%	\$0.57
Third Quarter	\$ 17.37	\$29.17	\$26.92	168%	155%	\$0.58
Fourth Quarter	\$ 19.17	\$30.80	\$26.11	161%	136%	\$0.58
Extra Dividend						\$0.03
<i>Year ended December 31, 2006</i>						
First Quarter	*	\$30.68	\$28.51	*	*	\$0.59
Second Quarter (through April , 2006)	*	\$	\$	*	*	\$0.60

(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.

Our common stock continues to trade in excess of net asset value. There can be no assurance, however, that our shares will continue to trade at a premium to our net asset value.

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 Debt and Equity Capital 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. In addition, this prospectus contains certain 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 other 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;

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

future changes in laws or regulations and conditions in our operating areas; and

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

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 lending and investment activity has generally been focused on private finance and commercial real estate finance, which included primarily the investment in non-investment grade commercial mortgage-backed securities, which we refer to as CMBS, and collateralized debt obligation bonds and preferred shares, which we refer to as CDOs.

On May 3, 2005, we completed the sale of our portfolio of CMBS and real estate related CDO investments. Upon the completion of this transaction, our lending and investment activity has been focused primarily on private finance investments. 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 growth, acquisitions, buyouts, recapitalizations, note purchases, bridge financings, 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 December 31, 2005, 2004, and 2003, was as follows:

	2005	2004	2003
Private finance	96%	76%	74%
Commercial real estate finance	4%	24%	26%

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 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 year 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.

Because we are a regulated investment company for tax purposes, we intend to distribute substantially all of our annual taxable income 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 years ended December 31, 2005, 2004, and 2003, were as follows:

	At and for the Years Ended December 31,		
	2005	2004	2003
(\$ in millions)			
Portfolio at value	\$3,606.4	\$3,013.4	\$2,584.6
Investments funded	\$1,675.8	\$1,524.5	\$ 931.5
Change in accrued or reinvested interest and dividends	\$ 6.6	\$ 52.2	\$ 45.0
Principal collections related to investment repayments or sales	\$1,503.4	\$ 909.2	\$ 788.3
Yield on interest-bearing investments ⁽¹⁾	12.8%	14.0%	14.7%

(1) The weighted average yield on interest-bearing investments is computed as the (a) annual stated interest plus the annual amortization of loan origination fees, original issue discount, and market discount on accruing interest-bearing investments less the annual amortization of loan origination costs, 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 years ended December 31, 2005, 2004, and 2003, were as follows:

	At and for the Years Ended December 31,		
	2005	2004	2003
(\$ in millions)			
Portfolio at value:			
Loans and debt securities	\$2,094.9	\$1,602.9	\$1,214.9
Equity securities	1,384.4	699.2	687.8
Total portfolio	\$3,479.3	\$2,302.1	\$1,902.7
Investments funded ⁽¹⁾	\$1,462.3	\$1,140.8	\$ 498.0
Change in accrued or reinvested interest and dividends	\$ 24.6	\$ 45.6	\$ 41.8
Principal collections related to investment repayments or sales	\$ 703.9	\$ 551.9	\$ 318.6
Yield on interest-bearing investments ⁽²⁾	13.0%	13.9%	15.0%

(1) Investments funded for the year ended December 31, 2004, included a \$47.5 million subordinated debt investment in The Hillman Companies, Inc. received in conjunction with the sale of Hillman as discussed below.

(2) The weighted average yield on loans and debt securities is computed as the (a) annual stated interest 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.

Our investment activity is 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 (a single debt investment that is a blend of senior and subordinated debt), 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. 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. Repayments include repayments of senior debt funded by us that was subsequently refinanced or repaid by the portfolio companies.

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. Recently, we have seen junior debt financing opportunities in the market that we believe are unattractive from a risk/return perspective. We believe many of these transactions employ too much leverage and are priced too low relative to the risks inherent in junior debt instruments. To address the currently active merger and acquisition market for private companies, our strategy is to focus on buyout and recapitalization transactions where we can manage risk through the structure and terms of our debt and equity investments and where we can potentially realize more attractive total returns from both current interest and fee income and future capital gains. We are also focusing our debt investing on smaller middle market companies where we can provide both senior and subordinated debt or unitranche debt, where our current yield may be lower than traditional subordinated debt. We believe that providing both senior and subordinated debt or unitranche debt provides greater protection in the capital structures of our portfolio companies.

Investments Funded. Investments funded and the weighted average yield on investments funded for the years ended December 31, 2005, 2004, and 2003, consisted of the following:

	2005 Investments Funded					
	Debt Investments		Buyout Investments		Total	
	Amount	Weighted Average Yield ⁽¹⁾	Amount	Weighted Average Yield ⁽¹⁾	Amount	Weighted Average Yield ⁽¹⁾
(\$ in millions)						
Loans and debt securities:						
Senior loans ⁽³⁾	\$ 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	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%
Equity	82.5		165.5		248.0	
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.

(2) Unitranche debt is a single debt investment that is a blend of senior and subordinated debt. The yield on a unitranche investment reflects the blended yield of senior and subordinated debt combined.

(3) Buyout senior loans funded include \$174.9 million which was repaid during the year.

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2004 Investments Funded

	Debt Investments		Buyout Investments		Total	
	Amount	Weighted Average Yield ⁽¹⁾	Amount	Weighted Average Yield ⁽¹⁾	Amount	Weighted Average Yield ⁽¹⁾
(\$ in millions)						
Loans and debt securities:						
Senior loans	\$ 25.1	9.1%	\$ 140.8	7.2%	\$ 165.9	7.5%
Unitranche debt ⁽²⁾	18.9	13.0%			18.9	13.0%
Subordinated debt	396.4	13.4%	320.1	15.5%	716.5	14.4%
Total loans and debt securities	440.4	13.2%	460.9	13.0%	901.3	13.1%
Equity	72.3		167.2		239.5	
Total	\$512.7		\$628.1		\$1,140.8	

2003 Investments Funded

	Debt Investments		Buyout Investments		Total	
	Amount	Weighted Average Yield ⁽¹⁾	Amount	Weighted Average Yield ⁽¹⁾	Amount	Weighted Average Yield ⁽¹⁾
(\$ in millions)						
Loans and debt securities:						
Senior loans	\$ 44.6	9.4%	\$ 28.6	2.6%	\$ 73.2	6.7%
Unitranche debt ⁽²⁾	25.0	15.5%			25.0	15.5%
Subordinated debt	354.8	14.6%	1.2	25.0%	356.0	14.6%
Total loans and debt securities	424.4	14.1%	29.8	3.5%	454.2	13.4%
Equity	15.6		28.2		43.8	
Total	\$440.0		\$58.0		\$498.0	

(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.

(2) Unitranche debt is a single debt investment that is a blend of senior and subordinated debt. The yield on a unitranche investment reflects the blended yield of senior and subordinated debt combined. In January and February 2006, we funded private finance investments totaling \$525.4 million.

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.

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. We believe that merger and acquisition activity in the middle market was strong in 2004 and continued into 2005, which has resulted in an increase in private finance investment opportunities, as well as increased repayments. We currently have an active pipeline of new investments under consideration. We believe that merger and acquisition activity for middle market companies will continue to be strong into 2006.

Portfolio Yield. The yield on the private finance loans and debt securities was 13.0% at December 31, 2005, as compared to 13.9% and 15.0% at December 31, 2004 and 2003, respectively. The weighted average yield on the private finance loans and debt securities may fluctuate from year to year 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 and the amount of lower-yielding senior or unitranche debt in the portfolio at the end of the year. The yield on the private finance portfolio has declined partly due to our strategy to pursue more buyout and recapitalization transactions, which may include investing in senior debt, as well as pursue unitranche investments.

Outstanding Investment Commitments. At December 31, 2005, we had outstanding private finance investment commitments totaling \$221.6 million, including the following:

\$33.3 million in the form of debt to Promo Works, LLC.

\$20.0 million in the form of debt to Business Loan Express, LLC.

\$14.0 million in the form of debt to S.B. Restaurant Company.

\$12.5 million in the form of equity to eight private venture capital funds.

\$12.0 million in the form of debt and equity to Amerex Group, LLC.

\$7.8 million in the form of debt to Mercury Air Centers, Inc.

\$7.5 million in the form of equity to Pennsylvania Avenue Investors, L.P., a limited partnership controlled by us that invests in private equity buyout funds.

\$6.5 million in co-investment commitments to Pine Creek Equity Partners, LLC.

We have various commitments to Callidus Capital Corporation (Callidus), which owns 80% of Callidus Capital Management, LLC, an asset management company that structures and manages collateralized debt obligations (CDOs), collateralized loan obligations (CLOs), and other related investments. Our commitment to Callidus consisted of the following at December 31, 2005:

(\$ in millions)	Committed Amount	Amount Drawn	Amount Available to be Drawn
Subordinated debt to support warehouse facilities & warehousing activities ⁽¹⁾	\$40.0	\$	\$40.0
Revolving line of credit for working capital	4.0	0.6	3.4
Total ⁽²⁾	\$44.0	\$0.6	\$43.4

(1) Callidus has a secured warehouse credit facilities with a third party for up to \$400 million. The facility is used primarily to finance the acquisition of loans pending securitization through a CDO or CLO. In conjunction with this warehouse credit facility, we have agreed to designate our \$40 million subordinated debt commitment for Callidus to draw upon to provide first loss capital as needed to support the warehouse facility.

(2) Subsequent to December 31, 2005, we provided Callidus with a new \$50.0 million revolving credit facility to support its purchase of middle market senior loans pending the sale of such loans to its warehouse credit facilities.

In addition, we had a commitment to Callidus to purchase preferred equity in future CLO transactions of \$32.4 million at December 31, 2005.

In addition to these outstanding investment commitments at December 31, 2005, 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 totaling \$178.6 million. See Financial Condition, Liquidity and Capital Resources.

Our largest investments at value at December 31, 2005, were in Advantage Sales & Marketing, Inc. and Business Loan Express, LLC (BLX). See Results of Operations for a discussion of the net change in unrealized appreciation or depreciation related to these investments.

Advantage Sales & Marketing, Inc. At December 31, 2005, our investment in Advantage Sales & Marketing, Inc. (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. We completed the purchase of a majority ownership in Advantage in June 2004.

Total interest and related portfolio income earned from our investment in Advantage for the years ended December 31, 2005 and 2004, was as follows:

	2005	2004
(\$ in millions)		
Interest income	\$30.9	\$15.5
Fees and other income	6.5	5.8
Total	\$37.4	\$21.3

Interest income from Advantage for the year ended December 31, 2004, included interest income of \$2.2 million which was paid in kind. The interest paid in kind was paid to us through the issuance of additional debt in 2004, which was subsequently paid in cash in 2005.

Net change in unrealized appreciation or depreciation included a net increase in unrealized appreciation on our investment in Advantage of \$378.4 million and \$24.3 million for the years ended December 31, 2005 and 2004, respectively.

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, we sold our majority equity interest in Advantage. We retained an equity investment valued at \$15 million as a minority shareholder. Advantage sold for an enterprise value of \$1.05 billion, subject to post-closing adjustments and we realized a gain on our equity sold of approximately \$430 million, also subject to post-closing adjustments. In connection with the transaction, we were repaid our \$184 million in subordinated debt outstanding. As consideration for the common stock we sold in the transaction, we received a \$150 million subordinated note, with the balance of the consideration paid in cash. Approximately \$34 million of our proceeds are subject to certain holdback provisions. In addition, there is potential for us to receive additional consideration through an earn-out payment that would be based on Advantage's 2006 audited results. Our realized gain of approximately \$430 million excludes any earn-out amounts.

Business Loan Express, LLC. At December 31, 2005, our investment in BLX totaled \$299.4 million at cost and \$357.1 million at value, or 8.9% of our total assets, which includes unrealized appreciation of \$57.7 million. We acquired BLX in 2000.

Total interest and related portfolio income earned from the Company's investment in BLX for the years ended December 31, 2005, 2004, and 2003, was as follows:

	2005	2004	2003
(\$ in millions)			
Interest income	\$ 14.3	\$ 23.2	\$ 21.9
Dividend income	14.0	14.8	7.8
Loan prepayment premiums			0.1
Fees and other income	9.2	12.0	16.9
Total	\$37.5	\$50.0	\$46.7

Interest and dividend income from BLX for the years ended December 31, 2005, 2004, and 2003, included interest and dividend income of \$8.9 million, \$25.4 million, and \$17.5 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. Accrued interest and dividends receivable at December 31, 2005, included accrued interest and fees due from BLX totaling \$5.7 million, of which \$5.5 million was paid in cash in the first quarter of 2006.

Net change in unrealized appreciation or depreciation included a net increase in unrealized appreciation on our investment in BLX of \$2.9 million for the year ended December 31, 2005, a net decrease in unrealized appreciation of \$32.3 million for the year ended December 31, 2004, and a net increase in unrealized appreciation of \$51.7 million for the year ended December 31, 2003.

BLX is a national, non-bank lender that participates in the SBA's 7(a) Guaranteed Loan Program and is licensed by the SBA as a Small Business Lending Company (SBLC). BLX is a nationwide preferred lender, as designated by the SBA, and originates, sells, and services small business loans. In addition, BLX originates conventional small business loans and small investment real estate loans. BLX has offices across the United States and is headquartered in New York, New York. Changes in the laws or regulations that govern SBLCs or the SBA 7(a) Guaranteed Loan Program or changes in government funding for this program could have a material adverse impact on BLX and, as a result, could negatively affect our financial results.

As a limited liability company, BLX's taxable income flows through directly to its members. BLX's annual taxable income generally differs from its book income for the fiscal year due to temporary and permanent differences in the recognition of income and expenses. We hold all of BLX's Class A and Class B interests, and 94.9% of the Class C interests. BLX's taxable income is first allocated to the Class A interests to the extent that dividends are paid in cash or in kind on such interests, with the remainder being allocated to the Class B and C interests. BLX declares dividends on its Class B interests based on an estimate of its annual taxable income allocable to such interests.

We have a commitment to BLX of \$30.0 million in the form of a subordinated revolving credit facility to provide working capital to the company that matures on April 30, 2006. There was \$10.0 million outstanding under this facility at December 31, 2005.

At December 31, 2005, BLX had a three-year \$275.0 million revolving credit facility provided by third party lenders that was scheduled to mature in January 2007. As the controlling equity owner in BLX, we had provided an unconditional guaranty to the

revolving credit facility lenders in an amount equal to 50% of the total obligations (consisting of principal, letters of credit issued under the facility, accrued interest, and other fees) of BLX under the revolving credit facility. At December 31, 2005, the principal amount outstanding on the revolving credit facility was \$228.2 million and letters of credit issued under the facility were \$41.7 million. The total obligation guaranteed by us at December 31, 2005, was \$135.4 million. On March 17, 2006, BLX closed on a new three-year \$500.0 million revolving credit facility that matures in March 2009, which replaced the existing facility. The revolving credit facility may be expanded through new or additional commitments up to \$600.0 million at BLX's option. This new facility provides for a sub-facility for the issuance of letters of credit for up to an amount equal to 25% of the committed facility. We have provided an unconditional guaranty to these revolving credit facility lenders in an amount equal to 50% of the total obligations (consisting of principal, letters of credit issued under the facility, accrued interest, and other fees) of BLX under this facility. At March 17, 2006, the principal amount outstanding on the revolving credit facility was \$217.6 million and letters of credit issued under the facility were \$41.7 million. The total obligation guaranteed by us on March 17, 2006, was \$130.0 million. This guaranty can be called by the lenders only in the event of a default under the BLX credit facility. BLX was in compliance with the terms of this facility at March 17, 2006.

At December 31, 2005, we had also provided four standby letters of credit totaling \$34.1 million in connection with four term securitization transactions completed by BLX.

STS Operating, Inc. On May 1, 2006, we announced the completion of the sale of STS Operating, Inc. (STS). We realized a gain on the sale of our common stock investment in STS of approximately \$94 million, subject to post-closing adjustments. The cost basis of our equity was \$3.5 million. As part of the consideration for the sale of our equity, we received a \$30 million subordinated note. Approximately \$10.7 million of our proceeds are subject to certain holdback provisions and post-closing adjustments. In addition, we were repaid our \$6.8 million in subordinated debt outstanding.

The Hillman Companies, Inc. On March 31, 2004, we sold our control investment in The Hillman Companies, Inc. (Hillman) for a total transaction value of \$510 million, including the repayment of outstanding debt and adding the value of Hillman's outstanding trust preferred shares. We were repaid our existing \$44.6 million in outstanding debt. Total consideration to us from this sale, including the repayment of debt, was \$245.6 million, which included net cash proceeds of \$198.1 million and the receipt of a new subordinated debt instrument of \$47.5 million. During the second quarter of 2004, we sold a \$5.0 million participation in our subordinated debt in Hillman to a third party, which reduced our investment, and no gain or loss resulted from the transaction. For the year ended December 31, 2004, we realized a gain of \$150.3 million on the transaction.

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 years ended December 31, 2005, 2004, and 2003, were as follows:

At and for the Years Ended December 31,

	2005		2004		2003	
	Value	Yield ⁽¹⁾	Value	Yield ⁽¹⁾	Value	Yield ⁽¹⁾
(\$ in millions)						
Portfolio at value:						
CMBS bonds	\$		\$373.8	14.6%	\$394.0	14.1%
CDO bonds and preferred shares			212.6	16.8%	186.6	16.7%
Commercial mortgage loans	102.6	7.6%	95.0	6.8%	83.6	8.6%
Real estate owned	13.9		16.9		12.8	
Equity interests	10.6		13.0		4.9	
Total portfolio	\$127.1		\$711.3		\$681.9	
Investments funded	\$213.5		\$383.7		\$433.5	
Change in accrued or reinvested interest	\$ (18.0)		\$ 6.6		\$ 3.2	
Principal collections related to investment repayments or sales ⁽²⁾	\$799.5		\$357.3		\$469.7	

(1) The weighted average yield on the interest-bearing investments is computed as the (a) annual stated interest 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.

Our commercial real estate investments funded for the years ended December 31, 2005, 2004, and 2003, were as follows:

	Face Amount	Discount	Amount Funded
(\$ in millions)			
For the Year Ended December 31, 2005			
CMBS bonds (4 new issuances) ⁽²⁾	\$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

For the Year Ended December 31, 2004

CMBS bonds (13 new issuances ⁽¹⁾)	\$419.1	\$(183.7)	\$235.4
CDO bonds and preferred shares (3 issuances)	40.5	(0.1)	40.4
Commercial mortgage loans	112.1	(8.2)	103.9
Equity interests	4.0		4.0
Total	\$575.7	\$(192.0)	\$383.7

For the Year Ended December 31, 2003

CMBS bonds (15 new issuances ⁽¹⁾)	\$508.5	\$(225.9)	\$282.6
CDO bonds and preferred shares (3 issuances)	145.8	(0.4)	145.4
Commercial mortgage loans	3.0		3.0
Equity interests	2.5		2.5
Total	\$659.8	\$(226.3)	\$433.5

(1) CMBS investments also include investments in issuances in which we have previously purchased CMBS bonds.

(2) The CMBS bonds invested in during the year ended December 31, 2005, were sold on May 3, 2005.

At December 31, 2005, we had outstanding funding commitments related to commercial mortgage loans and equity interests of \$81.2 million, including \$59.7 million to Timarron Capital, Inc., and commitments in the form of standby letters of credit and guarantees related to equity interests of \$7.1 million. In January 2006, certain assets of Timarron Capital, Inc. were sold and this outstanding commitment was canceled.

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 has been included in the net realized gain on the sale.

For tax purposes, we estimate that the net gain from the sale of the CMBS and CDO portfolio will be approximately \$244 million, after transaction and other costs of \$7.8 million. The difference between the net gain for book and tax purposes results from temporary differences in the recognition of income and expenses related to these assets.

Simultaneous with the sale of our CMBS and CDO portfolio, we entered into a platform assets purchase agreement with CWCcapital Investments LLC, an affiliate of the Caisse (CWCcapital), 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. This transaction was completed on July 13, 2005, and we received total cash proceeds of approximately \$5.3 million. No gain or loss resulted from the transaction. Under this agreement, we have agreed not to invest in CMBS and real estate-related CDOs and refrain from certain other real estate-related investing or servicing activities for a period of three years, 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.

We also entered into a transition services agreement with CWCcapital pursuant to which we provided certain transition services to CWCcapital for a limited transition period to facilitate the transfer of various servicing and other rights related to the CMBS and CDO portfolio. During the transition period, we agreed, among other things, to continue to act as servicer or special servicer with respect to the CMBS and CDO portfolio. Services provided under the transition services agreement, except for certain information technology services, were completed on July 13, 2005. For the year ended December 31, 2005, we received a total of \$1.4 million under the transition services agreement as reimbursement for employee and administrative expenses. These amounts reduced our employee expenses by \$1.1 million and administrative expenses by \$0.3 million.

Hedging Activities

We have invested in commercial mortgage loans and CMBS and CDO bonds, which were purchased at prices that were based in part on comparable Treasury rates. We have entered into transactions with one or more financial institutions to hedge against movement in Treasury rates on certain of the commercial mortgage loans and CMBS and CDO bonds. These transactions, referred to as short sales, involve receiving the proceeds from the short sales of borrowed Treasury securities, with the obligation to replenish the borrowed Treasury securities at a later date based on the then current market price, whatever that price may be. Risks in these contracts arise from movements in the value of the borrowed Treasury securities due to changes in interest rates and from the possible inability of counterparties to meet the terms of their contracts. If the value of the borrowed Treasury securities increases, we will incur losses on these transactions. These losses are limited to the increase in value of the borrowed Treasury securities; conversely, the value of the hedged commercial real estate assets would likely increase. If the value of the borrowed Treasury securities decreases, we will incur gains on these transactions which are limited to the decline in value of the borrowed Treasury securities; conversely, the value of the hedged commercial real estate assets would likely decrease. We do not anticipate nonperformance by any counterparty in connection with these transactions.

The total obligations to replenish borrowed Treasury securities, including accrued interest payable on the obligations, were \$17.7 million and \$38.2 million at December 31, 2005 and 2004, respectively. The net proceeds related to the sales of the borrowed Treasury securities plus or minus the additional cash collateral provided or received under the terms of the transactions were \$17.7 million and \$38.2 million at December 31, 2005 and 2004, respectively. The hedge at December 31, 2005, related to commercial mortgage loans and the hedge at December 31, 2004, related primarily to CMBS and CDO bonds. The amount of the hedge will vary from period to period depending upon the amount of commercial real estate assets that we own and have hedged as of the balance sheet date.

Accrued Interest and Dividends Receivable

Accrued interest and dividends receivable as of December 31, 2005 and 2004, was as follows:

	2005	2004
(\$ in millions)		
Private finance	\$58.7	\$59.8
Commercial real estate finance		
CMBS and CDO bonds		18.9
Commercial mortgage loans and other	1.7	0.8
Total	\$60.4	\$79.5

Total accrued interest and dividends receivable declined from December 31, 2004, to December 31, 2005, primarily as a result of the sale of our portfolio of CMBS and CDO assets on May 3, 2005. See Commercial Real Estate Finance above.

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 December 31, 2005 and 2004, our portfolio was graded as follows:

Grade	2005		2004	
	Portfolio at Value	Percentage of Total Portfolio	Portfolio at Value ⁽¹⁾	Percentage of Total Portfolio
(\$ in millions)				
1	\$ 1,643.0	45.6%	\$ 952.5	31.6%
2	1,730.8	48.0	1,850.5	61.4
3	149.1	4.1	121.2	4.0
4	26.5	0.7	11.7	0.4
5	57.0	1.6	77.5	2.6
	\$ 3,606.4	100.0%	\$ 3,013.4	100.0%

⁽¹⁾ The value of the CMBS and CDO assets sold on May 3, 2005, was \$586.4 million at December 31, 2004, and this value was included in Grade 2 assets. See *Commercial Real Estate Finance* above.

Grade 1 portfolio assets increased from \$952.5 million at December 31, 2004, to \$1.6 billion at December 31, 2005, primarily as a result of the appreciation in value of our investment in Advantage Sales & Marketing, Inc. (Advantage) as well as certain other companies. Advantage had a value of \$660.4 million, including \$402.7 million of unrealized appreciation, at December 31, 2005, as compared to a value of \$283.0 million, including \$24.3 million of unrealized appreciation, at December 31, 2004. See further discussion of the valuation of Advantage below. In March 2006, we announced that we had signed a definitive agreement to sell a majority interest in Advantage. See *Portfolio and Investment Activity* above for further discussion.

Total Grade 3, 4 and 5 portfolio assets were \$232.6 million and \$210.4 million, respectively, or were 6.4% and 7.0%, respectively, of the total portfolio at value at December 31, 2005 and 2004.

Grade 4 and 5 assets include loans, debt securities, and equity securities. We expect that a number of portfolio companies 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 of portfolio companies and related investment amount included in Grade 4 and 5 may fluctuate from period to period. We continue to follow our historical practice of working with such companies in order to recover the maximum amount of our investment.

Loans and Debt Securities on Non-Accrual Status. At December 31, 2005 and 2004, loans and debt securities at value not accruing interest for the total investment portfolio were as follows:

	2005	2004
(\$ in millions)		
Loans and debt securities in workout status (classified as Grade 4 or 5) ⁽¹⁾		
Private finance		
Companies more than 25% owned	\$ 15.6	\$ 34.4
Companies less than 5% owned	11.4	16.5
Commercial real estate finance	12.9	5.6
Loans and debt securities not in workout status		
Private finance		
Companies more than 25% owned	58.0	29.4
Companies 5% to 25% owned	0.5	0.7
Companies less than 5% owned	49.5	15.8
Commercial real estate finance	7.9	12.5
 Total	 \$ 155.8	 \$ 114.9
 Percentage of total portfolio	 4.3%	 3.8%

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

Loans and Debt Securities Over 90 Days Delinquent. Loans and debt securities greater than 90 days delinquent at value at December 31, 2005 and 2004, were as follows:

	2005	2004
(\$ in millions)		
Private finance	\$ 74.6	\$ 73.5
Commercial real estate finance		
CMBS bonds		49.0
Commercial mortgage loans	6.1	10.1
 Total	 \$ 80.7	 \$ 132.6
 Percentage of total portfolio	 2.2%	 4.4%

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.

Our loans and debt securities on non-accrual status increased by \$40.9 million during 2005. This net increase during the year resulted primarily from the move of two loans to non-accrual status totaling \$46.7 million at value at December 31, 2005, offset by a net decrease in the value of loans that were on non-accrual status at both December 31, 2005 and 2004.

As a result of these and other factors, the amount of the private finance portfolio that is greater than 90 days delinquent or on non-accrual status 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 \$60.7 million and \$43.9 million at December 31, 2005 and 2004, respectively.

RESULTS OF OPERATIONS**Comparison of the Years Ended December 31, 2005, 2004, and 2003**

The following table summarizes our operating results for the years ended December 31, 2005, 2004, and 2003.

(in thousands, except per share amounts)	2005	2004	Change	Percent Change	2004	2003	Change	Percent Change
Interest and Related Portfolio Income								
Interest and dividends	\$317,153	\$319,642	\$ (2,489)	(1)%	\$319,642	\$290,719	\$28,923	10%
Loan prepayment premiums	6,250	5,502	748	14%	5,502	8,172	(2,670)	(33)%
Fees and other income	50,749	41,946	8,803	21%	41,946	30,338	11,608	38%
Total interest and related portfolio income	374,152	367,090	7,062	2%	367,090	329,229	37,861	11%
Expenses								
Interest	76,798	75,650	1,148	2%	75,650	77,233	(1,583)	(2)%
Employee	78,300	53,739	24,561	46%	53,739	36,945	16,794	45%
Administrative	70,267	34,686	35,581	103%	34,686	22,387	12,299	55%
Total operating expenses	225,365	164,075	61,290	37%	164,075	136,565	27,510	20%
Net investment income before income taxes	148,787	203,015	(54,228)	(27)%	203,015	192,664	10,351	5%
Income tax expense (benefit), including excise tax	11,561	2,057	9,504	**	2,057	(2,466)	4,523	**
Net investment income	137,226	200,958	(63,732)	(32)%	200,958	195,130	5,828	3%
Net Realized and Unrealized Gains (Losses)								
Net realized gains	273,496	117,240	156,256	133%	117,240	75,347	41,893	56%
Net change in unrealized appreciation or depreciation	462,092	(68,712)	530,804	*	(68,712)	(78,466)	9,754	*

Total net gains (losses)	735,588	48,528	687,060	*	48,528	(3,119)	51,647	*
Net income	\$872,814	\$249,486	\$623,328	250%	\$249,486	\$192,011	\$57,475	30%
Diluted earnings per common share	\$ 6.36	\$ 1.88	\$ 4.48	238%	\$ 1.88	\$ 1.62	\$ 0.26	16%
Weighted average common shares outstanding	137,274	132,458	4,816	4%	132,458	118,351	14,107	12%
diluted								

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

** Percentage change is not meaningful.

Total Interest and Related Portfolio Income. Total interest and related portfolio income includes interest and dividend income, loan prepayment premiums, and fees and other income.

Interest and dividend income for the years ended December 31, 2005, 2004, and 2003, was composed of the following:

	2005	2004	2003
(\$ in millions)			
Interest			
Private finance loans and debt securities	\$251.0	\$195.2	\$177.3
CMBS and CDO portfolio	29.4	93.3	86.2
Commercial mortgage loans	7.6	9.4	9.0
Cash and cash equivalents and other	9.4	3.1	2.8
Total interest	297.4	301.0	275.3
Dividends	19.8	18.6	15.4
Total interest and dividends	\$317.2	\$319.6	\$290.7

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 weighted average yield varies from period to period based on the current stated interest on interest-bearing investments and the amount of loans and debt securities for which interest is not accruing. The interest-bearing investments in the portfolio at value and the weighted average yield on the interest-bearing investments in the portfolio at December 31, 2005, 2004, and 2003, were as follows:

	2005	2004	2003
(\$ in millions)			
Interest-bearing portfolio at value	\$2,211.4	\$2,301.2	\$1,891.9
Portfolio yield	12.8%	14.0%	14.7%

We sold our CMBS and CDO portfolio on May 3, 2005. As a result of this transaction, our interest income for the year ended December 31, 2005, was reduced due to the loss of interest from the portfolio sold (net of interest income earned on short-term excess cash investments). The CMBS and CDO portfolio sold on May 3, 2005, had a cost basis of \$718.1 million and a weighted average yield on the cost basis of the portfolio of approximately 13.8%. Excess cash proceeds from the sale that were not used for the repayment of debt or other general corporate purposes were held in cash and money market securities until the cash was reinvested in the portfolio.

The portfolio yield at December 31, 2005, of 12.8% as compared to the portfolio yield of 14.0% and 14.7% at December 31, 2004 and 2003, respectively, reflects the sale of the CMBS and CDO portfolio on May 3, 2005, as well as the mix of debt investments in the private finance portfolio. See the discussion of the private finance portfolio yield above under the caption Private Finance.

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 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. Dividend income included dividends from BLX on the Class B equity interests held by us of \$14.0 million, \$14.8 million, and \$7.8 million for the years ended December 31, 2005, 2004, and 2003, respectively. 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. For the

years ended December 31, 2004 and 2003, these dividends were paid through the issuance of additional Class B equity interests.

Loan prepayment premiums were \$6.3 million, \$5.5 million, and \$8.2 million for the years ended December 31, 2005, 2004, and 2003, respectively. 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.

Fees and other income primarily include fees related to financial structuring, diligence, transaction services, management and consulting services to portfolio companies, guarantees, and other services. 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, 2005, 2004, and 2003, included fees relating to the following:

	2005	2004	2003
(\$ in millions)			
Structuring and diligence	\$24.6	\$18.4	\$ 6.1
Transaction and other services provided to portfolio companies	2.9	3.2	4.5
Management, consulting and other services provided to portfolio companies and guaranty fees	20.8	17.4	18.7
Other income	2.4	2.9	1.0
Total fees and other income	\$50.7	\$41.9	\$30.3

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. Loan origination fees that represent yield enhancement on a loan are capitalized and amortized into interest income over the life of the loan.

Fees and other income for the year ended December 31, 2005, included structuring fees from Norwesco, Inc., Callidus Capital Corporation, Triax Holdings, LLC, and Meineke Car Care Centers, Inc. totaling \$9.4 million. Fees and other income for the year ended December 31, 2004, included structuring fees from Advantage, Financial Pacific Company, Mercury Air Centers, Inc. and Insight Pharmaceutical Corporation totaling \$10.0 million.

Fees and other income related to the CMBS and CDO portfolio were \$4.1 million, \$6.2 million, and \$2.8 million for the years ended December 31, 2005, 2004, and 2003, respectively.

Advantage and BLX were our largest investments at value at December 31, 2005 and 2004, and together represented 25.3% and 19.0%, of our total assets, respectively. BLX and

Hillman were our largest portfolio investments at December 31, 2003, and together represented 19.1% of our total assets at December 31, 2003.

Total interest and related portfolio income from these investments for the years ended December 31, 2005, 2004, and 2003, was as follows:

	2005	2004	2003
(\$ in millions)			
Advantage ⁽¹⁾	\$37.4	\$21.3	\$
BLX	\$37.5	\$50.0	\$46.7
Hillman ⁽¹⁾	\$	\$ 2.5	\$ 9.7

⁽¹⁾ Includes income from our controlled investments only.

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

Interest Expense. The fluctuations in interest expense during the years ended December 31, 2005, 2004, and 2003, were primarily attributable to changes in the level of our borrowings under various notes payable and debentures and our revolving line of credit. Our borrowing activity and weighted average cost of debt, including fees and closing costs, at and for the years ended December 31, 2005, 2004, and 2003, were as follows:

	2005	2004	2003
(\$ in millions)			
Total outstanding debt	\$1,284.8	\$1,176.6	\$954.2
Average outstanding debt	\$1,087.1	\$ 985.6	\$943.5
Weighted average cost ⁽¹⁾	6.5%	6.6%	7.5%

⁽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 and other facility fees 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 includes interest on our obligations to replenish borrowed Treasury securities related to our hedging activities of \$1.4 million, \$5.2 million, and \$5.9 million for the years ended December 31, 2005, 2004, and 2003, respectively.

Employee Expense. Employee expenses for the years ended December 31, 2005, 2004, and 2003, were as follows:

	2005	2004	2003
(\$ in millions)			
Salaries and employee benefits	\$57.3	\$40.7	\$28.3
Individual performance award (IPA)	7.0	13.4	
IPA mark to market expense (benefit)	2.0	(0.4)	
Individual performance bonus (IPB)	6.9		
Transition compensation, net	5.1		
Retention award			8.6
Total employee expense	\$78.3	\$53.7	\$36.9
Number of employees at end of period	131	162	125

The change in salaries and employee benefits reflects the effect of wage increases, the change in mix of employees given their area of responsibility and relevant experience level, and the termination of certain employees in our commercial real estate group as discussed below. Salaries and employee benefits expense has generally increased due to changes in the composition of our employee resources and compensation increases.

Transition compensation costs were \$5.1 million for the year ended December 31, 2005, including \$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 of \$5.1 million for the year ended December 31, 2005, reflect a reduction for salary reimbursements from CWC Capital under the transition services agreement of \$1.1 million. See the caption "Commercial Real Estate Finance" above for additional information.

Employee expense, excluding transition compensation, related to the 31 employees in our commercial real estate group who terminated employment in the third quarter of 2005 as a result of the sale of our CMBS and CDO portfolio, was \$4.5 million, \$6.8 million, and \$3.4 million for the years ended December 31, 2005, 2004, and 2003, respectively.

The Individual Performance Award (IPA) is a long-term incentive compensation program for certain officers. The IPA, which is generally determined annually at the beginning of each year, is deposited into a deferred compensation trust generally in four equal installments, on a quarterly basis, in the form of cash. 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 is deferred compensation, the cost of this award is not a current expense for purposes of computing our taxable income. The expense is deferred for tax purposes until distributions are made from the trust.

As a result of changes in regulation by the Jobs Creation Act of 2004 associated with deferred compensation arrangements, as well as an increase in the competitive market for recruiting talent in the private equity industry, the Compensation Committee and the Board of Directors have determined for 2005 and 2006 that a portion of the IPA should be replaced with an individual performance bonus (IPB). The IPB is distributed in cash to award recipients in equal bi-weekly installments (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 2006 and they are currently estimated to be approximately \$6.8 million each; however, the Compensation Committee may adjust the IPA or IPB as needed, or make new awards as new officers are hired. 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.

In December 2004, the FASB issued Statement No. 123 (Revised 2004), *Share-Based Payment* (the "Statement"), which requires companies to recognize the grant-date fair value of stock options and other equity-based compensation issued to employees in the income statement. The Statement was effective January 1, 2006, and it applies to our stock option plan. Our stock options are typically granted with ratable vesting provisions, and we intend to amortize the compensation cost over the service period. We will use the modified prospective method upon adoption. Under the modified prospective method, previously awarded but unvested options are accounted for in accordance with FASB Statement No. 123, except that amounts must be recognized in the income statement beginning January 1, 2006, instead of simply being disclosed. Awards granted on or after January 1, 2006, will be recognized in the income statement. Upon adoption, we estimate that the stock based compensation expense on a pre-tax basis, as measured under the Statement, will be approximately \$13 million, \$10 million, and \$3 million for the years ended December 31, 2006, 2007, and 2008, respectively, for stock-based compensation.

related to options granted prior to January 1, 2006, that has not historically been recorded in our statement of operations. This does not include any expense related to stock options that will be granted in the future as the fair value of those stock options will be determined at the time of grant. See Note 2, Summary of Significant Accounting Policies of our Notes to Consolidated Financial Statements.

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, stock record expenses, directors' fees, and various other expenses. Administrative expenses for the years ended December 31, 2005, 2004, and 2003, were as follows:

	2005	2004	2003
(\$ in millions)			
Administrative expenses, excluding investigation related costs	\$33.9	\$30.1	\$22.4
Investigation related costs	36.4	4.6	
Total administrative expenses	\$70.3	\$34.7	\$22.4

The increase in administrative expenses, excluding investigation related costs, for the year ended December 31, 2005, over the year ended December 31, 2004, was primarily due to increased expenses related to evaluating potential new investments of \$2.0 million, accounting fees of \$0.8 million, recruiting and employee training costs of \$0.6 million, and valuation assistance fees of \$0.5 million, offset by a decrease in expenses related to a decline in portfolio workout expenses of \$0.6 million.

Administrative expenses, excluding investigation related costs, were \$30.1 million for the year ended December 31, 2004, a \$7.7 million increase over administrative expenses of \$22.4 million for the year ended December 31, 2003. The increase in expenses primarily resulted from:

a net increase in accounting, consulting, and other fees of \$1.7 million. This increase is primarily attributable to fees associated with the implementation of the requirements under the Sarbanes-Oxley Act of 2002 (including Section 404) and valuation assistance,

an increase in deal costs related to evaluating potential new investments of \$1.6 million. Costs related to mezzanine lending 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,

an increase in expenses related to portfolio development and workout activities of \$1.5 million,

an increase in rent of \$1.4 million associated with the opening of an office in Los Angeles, CA and expanding our office space in Chicago, IL and New York, NY, and

an increase in other expenses, including stock record expense, insurance premiums and directors' fees of \$1.1 million, and travel expenses of \$0.8 million.

In addition, administrative expenses for the years ended December 31, 2005 and 2004, included costs associated with requests for information in connection with two government investigations. These expenses remain difficult to predict. See Legal Proceedings.

Income Tax Expense (Benefit), Including Excise Tax. Income tax expense (benefit) for the years ended December 31, 2005, 2004, and 2003, were as follows:

	2005	2004	2003
(\$ in millions)			
Income tax expense (benefit)	\$ 5.4	\$ 1.1	\$(2.5)
Excise tax expense	6.2	1.0	
Income tax expense (benefit), including excise tax	\$ 11.6	\$ 2.1	\$(2.5)

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. In addition, our estimated annual taxable income for 2005 exceeded our dividend distributions to shareholders for 2005 from such taxable income, and such estimated excess taxable income will be distributed in 2006. Therefore, we will be required to pay a 4% excise tax on the excess of 98% of our taxable income for 2005 over the amount of actual distributions for 2005. Accordingly, we accrued an estimated excise tax of \$6.2 million for the year ended December 31, 2005, based upon our current estimate of annual taxable income for 2005. See Financial Condition, Liquidity and Capital Resources.

Realized Gains and Losses. Net realized gains primarily result from the sale of equity securities associated with certain private finance investments, the sale of CMBS bonds and CDO bonds and preferred shares, 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. Net realized gains for the years ended December 31, 2005, 2004, and 2003, were as follows:

	2005	2004	2003
(\$ in millions)			
Realized gains	\$ 343.1	\$ 267.7	\$ 94.3
Realized losses	(69.6)	(150.5)	(19.0)
Net realized gains	\$ 273.5	\$ 117.2	\$ 75.3

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, 2005, 2004, and 2003, we reversed previously recorded unrealized appreciation or depreciation when gains or losses were realized as follows:

	2005 ⁽¹⁾	2004	2003
(\$ in millions)			
Reversal of previously recorded net unrealized appreciation associated with realized gains	\$(108.0)	\$(210.5)	\$(78.5)
Reversal of previously recorded net unrealized depreciation associated with realized losses	68.0	151.8	20.3
Total reversal	\$ (40.0)	\$ (58.7)	\$(58.2)

- (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, 2005, 2004, and 2003, were as follows:
(\$ in millions)

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 ⁽¹⁾	227.7
Other	9.3
Total commercial real estate	237.0
Total gross realized gains	\$343.1

2004

Portfolio Company	Amount
Private Finance:	
The Hillman Companies, Inc.	\$150.3
CorrFlex Graphics, LLC	25.7
Professional Paint, Inc.	13.7
Impact Innovations Group, LLC	11.1
The Hartz Mountain Corporation	8.3
Housecall Medical Resources, Inc.	7.2
International Fiber Corporation	5.2
CBA-Mezzanine Capital Finance, LLC	4.1
United Pet Group, Inc.	3.8

Oahu Waste Services, Inc.	2.8
Grant Broadcasting Systems II	2.7
Matrics, Inc.	2.1
SmartMail, LLC	2.1
Other	7.6
Total private finance	246.7
Commercial Real Estate:	
CMBS/CDO assets, net ⁽¹⁾	17.4
Other	3.6
Total commercial real estate	21.0
Total gross realized gains	\$267.7

2003

Portfolio Company	Amount
Private Finance:	
Blue Rhino Corporation	\$12.6
CyberRep	9.6
Morton Grove Pharmaceuticals, Inc.	8.5
Warn Industries, Inc.	8.0
Woodstream Corporation	6.6
Kirkland's Inc.	3.0
Julius Koch USA, Inc.	2.8
GC-Sun Holdings II, LP	2.5
Interline Brands, Inc.	1.7
WyoTech Acquisition Corporation	1.3
Advantage Mayer, Inc.	1.2
Other	3.2
Total private finance	61.0
Commercial Real Estate:	
CMBS/CDO assets, net ⁽¹⁾	31.6
Other	1.7
Total commercial real estate	33.3
Total gross realized gains	\$94.3

⁽¹⁾ Net of net realized losses from related hedges of \$0.7 million, \$3.8 million, and \$2.9 million for the years ended December 31, 2005, 2004, and 2003, respectively.

Realized losses for the years ended December 31, 2005, 2004, and 2003, were as follows:
(\$ in millions)

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 gross realized losses	\$ 69.6

2004

Portfolio Company	Amount
Private Finance:	
American Healthcare Services, Inc.	\$ 32.9
The Color Factory, Inc.	24.5
Executive Greetings, Inc.	19.3
Sydran Food Services II, L.P.	18.2
Ace Products, Inc.	17.6
Prosperco Finanz Holding AG	7.5
Logic Bay Corporation	5.0
Sun States Refrigerated Services, Inc.	4.7
Chickasaw Sales & Marketing, Inc.	3.8
Sure-Tel, Inc.	2.3
Liberty-Pittsburgh Systems, Inc.	2.0
EDM Consulting, LLC	1.9
Pico Products, Inc.	1.7
Impact Innovations Group, LLC	1.7
Interline Brands, Inc.	1.3
Startec Global Communications Corporation	1.1
Other	2.7

Total private finance	148.2
Commercial Real Estate:	
Other	2.3
Total commercial real estate	2.3
Total gross realized losses	\$ 150.5

2003

Portfolio Company	Amount
Private Finance:	
Allied Office Products, Inc.	\$ 7.7
Candlewood Hotel Company	2.7
North American Archery, LLC	2.1
Other	0.5
Total private finance	13.0
Commercial Real Estate:	
Other	6.0
Total commercial real estate	6.0
Total gross realized losses	\$ 19.0

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, 2005, portfolio investments recorded at fair value were approximately 90% 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 believe 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 our debt or equity investment. 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. We will record unrealized appreciation if we believe that the underlying portfolio company has appreciated in value and/or our equity security has appreciated in value. 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 companies. 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 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, from which we derive a single estimate of enterprise value. To determine the enterprise value of a portfolio company, we analyze its historical and projected financial results. 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, 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.

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.

Because of the lack of publicly available information about our private portfolio companies, we will 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 for a portion of the portfolio each quarter. 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 using these third-party valuation resources, when applicable, is submitted to our Board of Directors for its determination of fair value of the portfolio in good faith.

For the years ended December 31, 2005 and 2004, we received third-party valuation assistance from Duff & Phelps, LLC (Duff & Phelps) and Houlihan Lokey Howard and Zukin (Houlihan Lokey) for our private finance portfolio as follows:

	2005				2004			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Number of private finance portfolio companies reviewed:								
Duff & Phelps ⁽¹⁾	35	72	88	78	22	33	28	22
Houlihan Lokey ⁽²⁾	1	1	3	3				
Total number of private finance portfolio companies reviewed ⁽³⁾	36	72	89	80	22	33	28	22
Percentage of private finance portfolio reviewed at value:								
Duff & Phelps ⁽¹⁾	59.6%	83.0%	86.6%	87.9%	19.9%	21.6%	26.6%	42.2%
Houlihan Lokey ⁽²⁾	14.9%	14.9%	18.9%	23.5%				
Percentage of private finance portfolio reviewed at value ⁽³⁾	74.5%	83.0%	89.3%	92.4%	19.9%	21.6%	26.6%	42.2%

⁽¹⁾ During the third quarter of 2005, S&P Corporate Value Consulting merged with Duff & Phelps, LLC, a financial advisory and investment banking firm. The merged company operates under the name of Duff & Phelps, LLC.

⁽²⁾ Houlihan Lokey was initially engaged in the first quarter of 2005.

⁽³⁾ Duff & Phelps and Houlihan Lokey both reviewed Advantage Sales & Marketing, Inc. in Q2, Q3 and Q4 2005. In addition, Duff & Phelps and Houlihan Lokey both reviewed one other portfolio company in Q3 2005.

Professional fees for third-party valuation assistance for the years ended December 31, 2005 and 2004, were \$1.4 million and \$0.9 million, respectively.

Valuation Methodology – CMBS Bonds and CDO and CLO Bonds and Preferred Shares/Income Notes (CMBS/CDO/CLO Assets). CMBS/CDO/CLO Assets are carried at fair value, which is based on a discounted cash flow model that utilizes prepayment 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 CMBS/CDO/CLO Assets as comparable yields in the market change and/ or based on changes in estimated cash flows resulting from changes in prepayment or loss assumptions in the underlying collateral pool. As each bond ages, the expected amount of losses and the expected timing of recognition of such losses in the underlying collateral pool is updated and the revised cash flows are used in determining the fair value of the bonds. We determine the fair value of our CMBS/CDO/CLO Assets on an individual security-by-

security basis. When we sold a group of these real estate related investments in a pool in one or more transactions, the total value received for that pool was generally different than the sum of the fair values of the individual bonds or preferred shares.

Net Change in Unrealized Appreciation or Depreciation. For the portfolio, net change in unrealized appreciation or depreciation for the years ended December 31, 2005, 2004, and 2003, consisted of the following:

	2005 ⁽¹⁾	2004 ⁽¹⁾	2003 ⁽¹⁾
(\$ in millions)			
Net unrealized appreciation or depreciation	\$ 502.1	\$ (10.0)	\$(20.3)
Reversal of previously recorded unrealized appreciation associated with realized gains	(108.0)	(210.5)	(78.5)
Reversal of previously recorded unrealized depreciation associated with realized losses	68.0	151.8	20.3
Net change in unrealized appreciation or depreciation	\$ 462.1	\$ (68.7)	\$(78.5)

⁽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.

At December 31, 2005, our two largest investments were in Advantage and BLX. The following is a summary of the methodology that we used to determine the fair value of these investments.

Advantage Sales & Marketing, Inc. On March 2, 2006, a definitive agreement was signed to sell our majority equity interest in Advantage that indicated an enterprise value of approximately \$1.05 billion. See Portfolio and Investment Activity above. At December 31, 2005, we estimated the enterprise value of Advantage to be \$1.02 billion given that the closing of the transaction is subject to certain closing conditions and the sales price is subject to pre- and post-closing adjustments and certain holdback provisions. Using the enterprise value at December 31, 2005, we determined the value of our investments in Advantage to be \$660.4 million, which resulted in unrealized appreciation on our investment of \$402.7 million at December 31, 2005. This is an increase in unrealized appreciation in the fourth quarter of 2005 of \$224.9 million and an increase of \$378.4 million for the year ended December 31, 2005. Net change in unrealized appreciation or depreciation included a net increase in unrealized appreciation on our investment in Advantage of \$24.3 million for the year ended December 31, 2004. Both Houlihan Lokey and Duff & Phelps assisted us by reviewing our valuation of our investment in Advantage at December 31, 2005. Duff & Phelps also assisted us by reviewing our valuation of our investment in Advantage at December 31, 2004.

Business Loan Express, LLC. To determine the value of our investment in BLX at December 31, 2005, we performed four separate valuation analyses to determine a range of values: (1) analysis of comparable public company trading multiples, (2) analysis of BLX's value assuming an initial public offering, (3) analysis of merger and acquisition transactions for financial services companies, and (4) a discounted dividend analysis. We received valuation assistance from Duff & Phelps for our investment in BLX at December 31, 2005 and 2004.

With respect to the analysis of comparable public company trading multiples and the analysis of BLX's value assuming an initial public offering, we compute a median trailing and forward price earnings multiple to apply to BLX's pro-forma net income adjusted for certain capital structure changes that we believe would likely occur should the company be sold. Each quarter we evaluate which public commercial finance companies should be included in the comparable group. The comparable group at December 31, 2005, was

made up of CIT Group, Inc., Financial Federal Corporation, GATX Corporation, and Marlin Business Services Corporation. The December 31, 2004, comparable group included CapitalSource, Inc., however, it has been excluded from the December 31, 2005, comparable group as it elected REIT status and no longer trades as a commercial finance company. The remaining comparable group for December 31, 2005, is consistent with the comparable group at December 31, 2004.

Our investment in BLX at December 31, 2005, was valued at \$357.1 million. This fair value was within the range of values determined by the four valuation analyses. Unrealized appreciation on our investment was \$57.7 million at December 31, 2005. Net change in unrealized appreciation or depreciation included a net increase in net unrealized appreciation of \$2.9 million for the year ended December 31, 2005, a net decrease in unrealized appreciation of \$32.3 million for the year ended December 31, 2004, and a net increase in unrealized appreciation of \$51.7 million for the year ended December 31, 2003.

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 137.3 million, 132.5 million, and 118.4 million for the years ended December 31, 2005, 2004, and 2003, 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.

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 results in the deferment of gains for tax purposes until notes 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. 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 into the next tax year and pay a 4% excise tax on such income, as required. See Financial Condition, Liquidity and Capital Resources 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.

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

Our portfolio has historically generated cash flow from which we pay dividends to shareholders and fund new investment activity. 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 years ended December 31, 2005, 2004, and 2003, was as follows:

	2005	2004	2003
(\$ in millions)			
Net cash provided by (used in) operating activities	\$ 116.0	\$ (179.3)	\$ 80.3
Add: portfolio investments funded	1,668.1	1,472.4	930.6
Total cash provided by operating activities before new investments	\$1,784.1	\$1,293.1	\$1,010.9

From the cash provided by operating activities before new investments, we make new portfolio investments, fund our operating activities, and pay dividends to shareholders. We also raise new debt and equity capital from time to time in order to fund our investments and operations.

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.

Dividends to common shareholders for the years ended December 31, 2005, 2004, and 2003, were \$314.5 million, \$299.3 million, and \$267.8 million, respectively. Total regular quarterly dividends were \$2.30, \$2.28, and \$2.28 per common share for the years ended December 31, 2005, 2004, and 2003, respectively. An extra cash dividend of \$0.03 and \$0.02 per common share was declared during 2005 and 2004, respectively, and was paid to shareholders on January 27, 2006, and January 28, 2005, respectively.

Dividends are generally determined based upon an estimate of annual taxable income, which includes our taxable interest, dividend and fee income, as well as taxable net capital gains. As discussed above, 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. Taxable income includes non-cash income, such as changes in accrued and reinvested interest and dividends 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.

Our Board of Directors reviews the dividend rate quarterly, and may adjust the quarterly dividend throughout the year. Dividends are declared based upon our estimate of annual taxable income available for distribution to shareholders. 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 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. Excess taxable income carried over and paid out in the next year may be subject to a 4% excise tax. See **Other Matters** **Regulated Investment Company Status** above. 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.

Our estimated annual taxable income for 2005 exceeded our dividend distributions to shareholders for 2005 from such taxable income, and, therefore, we will carry over excess taxable income, which is currently estimated to be \$163.8 million, for distribution to shareholders in 2006. Accordingly, for the year ended December 31, 2005, we have accrued an estimated excise tax of \$6.2 million. However, our taxable income for 2005 is an estimate and will not be finally determined until we file our 2005 tax return in September 2006, and therefore, the amount of excess taxable income carried over from 2005 into 2006 may be different than this estimate. See **Risk Factors** and Note 10, **Dividends and Distributions and Excise Taxes** of our Notes to Consolidated Financial Statements.

Because we are a regulated investment company, we distribute our taxable income and, therefore, from time to time we will raise new debt or equity capital in order to fund our investments and operations.

At December 31, 2005 and 2004, our liquidity portfolio, cash and investments in money market securities, total assets, total debt outstanding, total shareholders' equity, debt to equity ratio and asset coverage for senior indebtedness were as follows:

(\$ in millions)	2005	2004
Liquidity portfolio (including money market securities: 2005-\$100.0; 2004-\$0)	\$ 200.3	\$
Cash and investments in money market securities (including money market securities: 2005-\$22.0; 2004-\$0)	\$ 53.3	\$ 57.2
Total assets	\$4,025.9	\$3,261.0
Total debt outstanding	\$1,284.8	\$1,176.6
Total shareholders' equity	\$2,620.5	\$1,979.8
Debt to equity ratio	0.49	0.59
Asset coverage ratio ⁽¹⁾	309%	280%

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

We currently 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.

During the fourth quarter of 2005, we established a liquidity portfolio that is composed of money market securities and U.S. Treasury bills. The value and yield of the money market securities were \$100.0 million and 4.1% and were held in money market funds, at December 31, 2005. The value and yield of the Treasury bills were \$100.3 million and 4.3%, respectively, at December 31, 2005. The Treasury bills are due in June 2006. The liquidity portfolio was established to provide a pool of liquid assets within our balance sheet. Our investment portfolio is primarily composed of private, illiquid assets for which there is no readily available market. Our liquidity was reduced when we sold our portfolio of CMBS assets, particularly BB rated bonds, which were generally more liquid than assets in our private finance portfolio. Given the level of taxable income we are carrying over from 2005 for distribution in 2006, we established the liquidity portfolio to ensure that we had ample resources from which to distribute this excess taxable income in 2006. We will assess the amount held in and the composition of the liquidity portfolio throughout the year.

We did not sell new equity in a public offering during the year ended December 31, 2005. For the years ended December 31, 2004 and 2003, we sold equity of \$73.5 million and \$422.9 million, respectively. Shareholders' equity increased by \$77.5 million, \$51.3 million, and \$21.2 million through the exercise of employee options, the collection of notes receivable from the sale of common stock, and the issuance of shares through our dividend reinvestment plan for the years ended December 31, 2005, 2004, and 2003, respectively. On January 31, 2006, we sold 3.0 million shares of our common stock for proceeds of \$83.0 million, net of underwriting discounts and estimated offering expenses. We primarily used the proceeds from the equity offering to repay outstanding borrowings under our revolving line of credit and for general corporate purposes.

We employ an asset-liability management approach that focuses on matching the estimated maturities of our loan and investment portfolio to the estimated maturities of our borrowings. We use our revolving line of credit facility as a means to bridge to 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. Availability on the revolving line of credit, net of amounts committed for standby letters of credit issued under the line of credit facility, was \$643.6 million on December 31, 2005. We evaluate our interest rate exposure on an ongoing basis. Generally, we seek to fund our primarily fixed-rate investment 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.

At December 31, 2005 and 2004, we had outstanding debt as follows:

	2005				2004			
	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⁾
(\$ in millions)								
Notes payable and debentures:								
Unsecured notes payable	\$ 1,164.5	\$ 1,164.5	6.2%	1.8%	\$ 981.4	\$ 981.4	6.5%	2.0%
SBA debentures	28.5	28.5	7.5%	0.1%	84.8	77.5	8.2%	0.2%
OPIC loan					5.7	5.7	6.6%	
Total notes payable and debentures	1,193.0	1,193.0	6.3%	1.9%	1,071.9	1,064.6	6.6%	2.2%
Revolving line of credit	772.5	91.8	5.6% ⁽³⁾	0.2%	552.5	112.0	4.7% ⁽³⁾	0.2%
Total debt	\$ 1,965.5	\$ 1,284.8	6.5%⁽⁴⁾	2.1%	\$ 1,624.4	\$ 1,176.6	6.6%⁽⁴⁾	2.4%

(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 and other facility fees 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 portfolio return to cover interest payments is calculated as the December 31, 2005 and 2004, annualized cost of debt per class of financing outstanding divided by total assets at December 31, 2005 and 2004.

(3) The annual interest cost reflects the interest rate payable for borrowings under the revolving line of credit. In addition to the current interest rate payable, there were annual costs of commitment fees and other facility fees of \$3.3 million and \$1.8 million at December 31, 2005 and 2004, respectively.

(4) The annual interest cost for total debt includes the annual cost of commitment fees and other facility fees regardless of the amount outstanding on the facility as of the balance sheet date.

Unsecured Notes Payable. We have issued unsecured long-term notes to institutional investors, primarily insurance companies. The notes have five- or seven-year maturities, with maturity dates beginning in 2006 and generally have fixed rates of interest. The notes generally require payment of interest only semi-annually, and all principal is due upon maturity.

On October 13, 2005, we issued \$261.0 million of five-year and \$89.0 million of seven-year unsecured long-term notes, primarily to insurance companies. The five- and seven-year notes have fixed interest rates of 6.2% and 6.3%, respectively, and have substantially the same terms as our existing unsecured long-term notes. We used a portion of

the proceeds from the new long-term note issuance to repay \$125.0 million of our existing unsecured long-term notes that matured on October 15, 2005, and had an annual weighted average interest cost of 8.3%. During the second quarter of 2005, we repaid \$40.0 million of the unsecured notes payable.

On May 1, 2006, we issued \$50 million of seven-year, unsecured notes with a fixed interest rate of 6.75%. This debt matures in May 2013. The proceeds from the issuance of the notes were used to repay \$25 million of 7.49% unsecured long-term notes that matured on May 1, 2006, with the remainder being used to fund new portfolio investments and for general corporate purposes.

Small Business Administration Debentures. Through our small business investment company subsidiary, we have debentures payable to the Small Business Administration with contractual maturities of ten years. The notes require payment of interest only semi-annually, and all principal is due upon maturity. During the years ended December 31, 2005 and 2004, we repaid \$49.0 million and \$17.0 million, respectively, of this outstanding debt. Under the small business investment company program, we may borrow up to \$124.4 million from the Small Business Administration.

Revolving Line of Credit. At December 31, 2005, we had an unsecured revolving line of credit with a committed amount of \$772.5 million. The revolving line of credit, which closed on September 30, 2005, replaced our previous revolving line of credit and

expires on September 30, 2008. The revolving line of credit may be expanded through new or additional commitments up to \$922.5 million at our option. The revolving line of credit generally bears interest at a rate equal to (i) LIBOR (for the period we select) plus 1.30% 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. 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.

At December 31, 2005, there was \$91.8 million outstanding on our unsecured revolving line of credit. The amount available under the line at December 31, 2005, was \$643.6 million, net of amounts committed for standby letters of credit of \$37.1 million. Net borrowings under the revolving lines of credit for the year ended December 31, 2005, were \$20.3 million.

We have various financial and operating covenants required by the revolving line of credit and notes payable and debentures. These covenants require us to maintain certain financial ratios, including debt to equity and interest coverage, and a minimum net worth. Our credit facilities limit our ability to declare dividends if we default under certain provisions. As of December 31, 2005 and 2004, we were in compliance with these covenants.

The following table shows our significant contractual obligations for the repayment of debt and payment of other contractual obligations as of December 31, 2005.

(\$ in millions)	Payments Due By Year						
	Total	2006	2007	2008	2009	2010	After 2010
Notes payable and debentures:							
Unsecured long-term notes payable	\$1,164.5	\$175.0	\$	\$153.0	\$267.0	\$408.0	\$161.5
SBA debentures	28.5						28.5
Revolving line of credit ⁽¹⁾	91.8			91.8			
Operating leases	29.0	4.5	4.4	4.5	4.6	4.4	6.6
Total contractual obligations	\$1,313.8	\$179.5	\$4.4	\$249.3	\$271.6	\$412.4	\$196.6

⁽¹⁾ At December 31, 2005, \$643.6 million remained unused and available, net of amounts committed for standby letters of credit of \$37.1 million issued under the credit facility.

Off-Balance Sheet Arrangements

The following table shows our contractual commitments that may have the effect of creating, increasing, or accelerating our liabilities as of December 31, 2005.

(\$ in millions)	Amount of Commitment Expiration Per Year						
	Total	2006	2007	2008	2009	2010	After 2010
Guarantees	\$148.6	\$1.3	\$136.2	\$ 3.1	\$2.5	\$	\$5.5
Standby letters of credit ⁽¹⁾	37.1	0.1		37.0			

Total commitments	\$185.7	\$1.4	\$136.2	\$40.1	\$2.5	\$	\$5.5
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(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 in September 2008.

In addition, we had outstanding commitments to fund investments totaling \$302.8 million at December 31, 2005. 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 operations and require management's most difficult, complex, or subjective judgments. Our critical accounting policies are those applicable to the valuation of investments and certain revenue recognition matters as discussed below.

Valuation of Portfolio Investments. As a business development company, we invest in illiquid securities including debt and equity securities of companies. 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. We determine 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. Our valuation policy considers the fact that no ready market exists for substantially all of the securities in which we invest. Our valuation policy is intended to provide a consistent basis for determining the fair value of the portfolio. We will record unrealized depreciation on investments when we believe 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 our 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. We will record unrealized appreciation if we believe that the underlying portfolio company has appreciated in value and/or our equity security has 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. 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.

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.

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. Loans in workout status that are classified as Grade 4 or 5 assets under our internal grading system 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 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. Prepayment premiums are recorded on loans and debt securities when received.

Equity Securities. Our 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 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 to account for restrictions on resale or minority ownership positions.

The value of our 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 we have 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.

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 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.

Fee Income. Fee income includes fees for guarantees 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. Guaranty fees are generally recognized as income over the related period of the guaranty. 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.

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, 2005, 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⁾
Unsecured Long-term Notes Payable				
1996	\$ 0	\$ 0	\$	N/A
1997	0	0		N/A
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
Small Business Administration Debentures ⁽⁵⁾				
1996	\$ 61,300,000	\$2,485	\$	N/A
1997	54,300,000	2,215		N/A
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
Overseas Private Investment Corporation Loan				
1996	\$ 8,700,000	\$2,485	\$	N/A
1997	8,700,000	2,215		N/A
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

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2004	5,700,000	2,801	N/A
2005	0	0	N/A

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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⁾
Revolving Lines of Credit				
1996	\$ 45,099,000	\$2,485	\$	N/A
1997	38,842,000	2,215		N/A
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
Auction Rate Reset Note				
1996	\$ 0	\$ 0	\$	N/A
1997	0	0		N/A
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
Master Repurchase Agreement and Master Loan and Security Agreement				
1996	\$ 85,775,000	\$2,485	\$	N/A
1997	225,821,000	2,215		N/A
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
Senior Note Payable⁽⁶⁾				
1996	\$ 20,000,000	\$2,485	\$	N/A

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1997	20,000,000	2,215	N/A
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

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⁾
Bonds Payable				
1996	\$ 54,123,000	\$ 2,485	\$	N/A
1997	0	0		N/A
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
Redeemable Cumulative Preferred Stock⁽⁵⁾⁽⁷⁾				
1996	\$ 1,000,000	\$ 242	\$ 100	N/A
1997	1,000,000	217	100	N/A
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
Non-Redeemable Cumulative Preferred Stock⁽⁵⁾				
1996	\$ 6,000,000	\$ 242	\$ 100	N/A
1997	6,000,000	217	100	N/A
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

(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, as senior securities are not registered for public trading.

- (5) Issued by our small business investment company subsidiary to the Small Business Administration. These categories of senior securities are not subject to the asset coverage requirements of the 1940 Act. See Certain Government Regulations Small Business Administration Regulations.
- (6) We were the obligor on \$15 million of the senior notes. Our small business investment company subsidiary was the obligor on the remaining \$5 million, which is not subject to the asset coverage requirements of the 1940 Act.
- (7) The Redeemable Cumulative Preferred Stock was reclassified to Other Liabilities on the accompanying financial statements during 2003 in accordance with SFAS No. 150.

BUSINESS

General

We are a business development company, or BDC, and we are in the private equity business. 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, we have invested more than \$9 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. We are not venture capitalists, and we generally do not provide seed, or early stage, capital. At December 31, 2005, our private finance portfolio included investments in over 100 companies that generate aggregate annual revenues of over \$10 billion and employ more than 85,000 people.

Our investment objective is to achieve current income and capital gains. In order to achieve this objective, we invest in companies in a variety of industries.

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-constructed 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. We have chosen these investments 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 equity features, such as nominal cost warrants, or by investing in equity instruments. For the years 1998 through 2005, we have realized \$575.1 million 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.

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 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 of the increased 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 are led by an experienced management team with our senior officers possessing, on average, 20 years of experience in the private equity industry.

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 December 31, 2005, our combined aggregate cash flow Internal Rate of Return (IRR) has been approximately 20% for private finance and 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 \$3.2 billion, earned \$1.6 billion on this invested capital, and

therefore, received \$4.8 billion in total investment proceeds from the exits of these investments. The weighted average holding period of these investments was 34 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 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 18% and for CMBS/ CDO investments was approximately 24% 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 illiquid investing. 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, 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 securities. 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-constructed balance sheet

We generally target investments in the following industries as they tend to be less cyclical, cash flow intensive and generate a high return on invested capital:

Business Services
Financial Services
Consumer Products

Healthcare Services
Energy Services

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. 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 \$100 million and buyout investments of up to \$250 million of invested capital.

Debt investments may include senior loans, unitranche debt (a single debt investment that is a blend of senior and subordinated debt), 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 subordinated or mezzanine debt. We may make equity investments for a minority equity stake in portfolio companies in conjunction with our debt investments. We generally target a minimum weighted average portfolio yield of 10% on the debt component of our private finance portfolio. The weighted average yield on our private finance loans and debt securities was 13.0% at December 31, 2005.

Senior loans generally carry a floating rate of interest, usually set as a spread over LIBOR, and generally require payments of both principal and interest throughout the life of the loan. Interest is generally paid to us monthly or quarterly. Senior loans generally have maturities of three to five years. Unitranche debt and subordinated debt generally carry a fixed rate of interest generally with maturities of five to ten years and generally have 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 is generally paid to us quarterly. At December 31, 2005, 87% of our private finance loans and debt securities carried a fixed rate of interest and 13% carried a floating rate of interest.

Through our wholly owned subsidiary, AC Finance LLC, (AC Finance) we may underwrite senior loans related to our portfolio investments or for other companies that are not in our portfolio. When AC Finance underwrites senior loans, we may earn a fee for such loan underwriting activities. Senior loans originated and underwritten by AC Finance 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) or funds managed by Callidus, a portfolio company controlled by us. After completion of the sale process, we may or may not retain a position in these senior loans. 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.

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 senior loans and subordinated debt, 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. We believe that the transaction fees charged for the services we provide to portfolio companies are generally comparable with transaction fees charged by others in the private equity industry for performing similar services. 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 unintranche debt are generally secured, however in a liquidation scenario, the collateral 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 December 31, 2005, 60.2% of the private finance portfolio at value consisted of loans and debt securities and 39.8% consisted of equity securities (equity securities included 26.4% in investment cost basis and 13.4% in net unrealized appreciation). At December 31, 2005, 54.2% of the private finance investments at value were in companies more than 25% owned, 4.6% were in companies 5% to 25% owned, and 41.2% were in companies less than 5% owned.

Our ten largest investments at value at December 31, 2005, were as follows:

At December 31, 2005				
(\$ in millions)				
Portfolio Company	Company Information	Cost	Value	Percentage of Total Assets
Advantage Sales & Marketing, Inc. ⁽¹⁾⁽²⁾	Sales and marketing agency providing outsourced sales, merchandising, and marketing services to the consumer packaged goods industry.	\$257.7	\$660.4	16.4%
Business Loan Express, LLC ⁽¹⁾	Originates, sells, and services primarily real estate secured small business loans specifically for businesses with financing needs of up to \$4.0 million. Provides SBA 7(a) loans, conventional small business loans and small investment real estate loans. Nationwide non-bank preferred lender in the SBA s 7(a) guaranteed loan program.	\$299.4	\$357.1	8.9%
Mercury Air Centers, Inc.	Owns and operates fixed base operations under long-term leases from local airport authorities, which generally consist of terminal and hangar complexes that service the needs of the general aviation community.	\$113.3	\$167.1	4.2%
Financial Pacific Company	Specialized commercial finance company that leases business-essential equipment to small businesses nationwide.	\$95.0	\$127.2	3.2%
Meineke Car Care Centers, Inc.	Business format franchisor in the car care sector of the automotive aftermarket industry with approximately 900 locations worldwide.	\$126.5	\$126.2	3.1%
Norwesco, Inc.	Designs, manufactures and markets a broad assortment of polyethylene tanks primarily to the agricultural and septic tank markets.	\$120.0	\$120.0	3.0%
Triview Investments, Inc.	Holds investments in Triax Holdings, LLC, a developer and marketer of specialty pharmaceutical products with a focus on dermatology, and Longview Cable & Data LLC, a multi-system cable operator.	\$151.7	\$87.0	2.2%

At December 31, 2005

(\$ in millions) Portfolio Company	Company Information	Cost	Value	Percentage of Total Assets
Insight Pharmaceuticals Corporation	Over-the-counter pharmaceutical company with a broad portfolio of 20 brands, including Sucrets, Anacin, NIX and Bonine.	\$89.6	\$85.3	2.1%
STS Operating, Inc.	Distributes systems, components and engineering services for hydraulic, pneumatic, electronic and filtration systems.	\$10.1	\$72.1	1.8%
Healthy Pet Corp.	Veterinary hospitals offering medical and surgical services, specialized treatments, diagnostic services, pharmaceutical products, as well as routine health exams and vaccinations.	\$68.4	\$68.4	1.7%

(1) See Management's Discussion and Analysis of Financial Condition and Results of Operations.

(2) In March 2006, we sold our majority interest in Advantage. See Management's Discussion and Analysis of Financial Condition and Results of Operations for further detail.

We monitor the portfolio to maintain diversity within the industries in which we invest. Our portfolio is not concentrated and we currently do not have a policy with respect to concentrating (i.e., investing 25% or more of our total assets) in any particular industry. 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 December 31, 2005 and 2004, was as follows:

	2005	2004
Industry		
Business services	45%	32%
Financial services	15	21
Consumer products	14	20
Industrial products	10	8
Retail	3	2
Healthcare services	2	8
Energy services	2	2
Broadcasting and cable	1	2
Other ⁽¹⁾	8	5
Total	100%	100%

(1) Includes investments in senior debt CDO and CLO funds. These funds invest in senior debt representing a variety of industries.

Commercial Real Estate Finance Portfolio. Since 1998, our commercial real estate investments have generally been 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. With regard to CMBS, non-investment grade means that nationally recognized statistical rating organizations rate these securities below the top four investment-grade rating categories (i.e., AAA

through BBB), and are sometimes referred to as junk bonds. 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. After the completion of this sale, our commercial real estate finance portfolio consists of commercial mortgage loans, real estate owned and equity interests, which totaled \$127.1 million at value on December 31, 2005.

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 sold certain commercial real estate related assets, including servicer advances, intellectual property, software and other platform assets, subject to certain adjustments. Under this agreement, we have agreed not to invest in CMBS and real estate related CDOs and refrain from certain other real estate related investing or servicing activities for a period of three years, subject to certain limitations and excluding our existing portfolio and related activities.

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 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.

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 generally 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 up to one year 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, lien protection, 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 warrants or options to buy a minority interest in the portfolio company. The warrants we receive with our debt securities generally require only a nominal cost to exercise, and thus, if the portfolio company appreciates in value, we achieve additional investment return from this equity interest. We may structure the warrants to provide minority rights provisions and event-driven puts. In many cases, we will also obtain registration rights in connection with these equity interests, which may include demand and piggyback registration rights.

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;

Final investment committee approval;

Approval by the Executive 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 Executive 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.

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 oversees the overall performance of the portfolio, including reviewing the performance of selected portfolio companies, overseeing portfolio companies in workout status, reviewing and approving certain amendments or modifications to existing investments, reviewing and approving certain portfolio exits, and reviewing and approving certain actions by portfolio companies whose voting securities are more than 50% owned by us. 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), and three 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 to monitor the quality of our 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.

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 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 a valuation policy and a consistently applied valuation process. 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 believe 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 our debt or equity investment. 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. We will record unrealized appreciation if we believe that the underlying portfolio company has appreciated in value and/or our equity security has appreciated in value. 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 companies. 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. 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, from which we derive a single estimate of enterprise value. To determine the enterprise value of a portfolio company, we analyze its historical and projected financial results. 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, 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.

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. To balance the lack of publicly available information about our private portfolio companies, we will continue to work with third-party consultants to obtain assistance in determining fair value for a portion of the private finance portfolio each quarter as discussed below.

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 a description 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 deal team, led by the Managing Director or senior officer who is responsible for the portfolio company relationship.

The CVO reviews the preliminary valuation as determined by the deal team.

The CVO, members of the valuation team, and third-party consultants, as applicable (see below), 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 with the third-party consultants (see below) to discuss the assistance provided and results.

The Board of Directors and the CVO meet to discuss and review valuations.

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 using these third-party valuation resources, when applicable, is submitted to our Board of Directors for its determination of fair value of the portfolio in good faith.

During 2005, we received third-party valuation assistance from Duff & Phelps, LLC (Duff & Phelps) and Houlihan Lokey Howard and Zukin (Houlihan Lokey). We currently intend to continue to obtain valuation assistance from third parties. 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 December 31, 2005, Duff & Phelps and Houlihan Lokey assisted us by reviewing our valuation of 80 portfolio companies, which represented 92.4% of the private finance portfolio at value. See Management's Discussion and Analysis of Financial Condition and Results of Operations.

Disposition of Investments

We manage our portfolio of investments in an effort to maximize our expected returns. Our portfolio is large and we frequently are repaid by our borrowers and exit our debt and equity investments as portfolio companies are sold, recapitalized or complete an initial public offering. In our debt investments where we have equity features, we frequently are 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 Code. As such, we are not subject to corporate-level income taxation on income we timely distribute to our stockholders as dividends. We determine our regular quarterly dividends based upon an estimate of annual taxable income, 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 are not included in taxable income until they are realized. 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. 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 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 amount of excess taxable income that may be carried over for distribution in the next year under the Code is approximately three quarters of dividend payments. Excess taxable income carried over and paid out in the next year may be subject to a 4% excise tax (see 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, our average annual total return to shareholders (assuming all dividends were reinvested) was 18.0%. Over the past one, three, five and ten years, our total return to shareholders (assuming all dividends were reinvested) has been 23.5%, 20.6%, 17.1% and 19.8%, 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 1986 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. Our predecessor corporation was incorporated under the laws of the District of Columbia in 1958 and we reorganized as a Maryland corporation in 1993. We have a wholly owned subsidiary, Allied Investments L.P. (Allied Investments), that is licensed under the Small Business Investment Act of 1958 as a Small Business Investment Company. We own all of the partnership interests in Allied Investments. The assets held by Allied Investments represented 2.6% of our total assets at December 31, 2005. See Certain Government Regulations below for further information about small business investment company regulation.

In addition, 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 on our transactions, as well as structuring, transaction, management, and other services to Allied

Capital and our portfolio companies. A.C. Corporation has a wholly owned subsidiary, AC Finance LLC, that generally underwrites and arranges senior loans for our portfolio companies and other third parties.

Our executive offices are located at 1919 Pennsylvania Avenue, 3rd Floor, NW, Washington, DC 20006-3434 and our telephone number is (202) 721-6100. In addition, we have regional offices in Chicago, Los Angeles, and New York.

Employees

At December 31, 2005, we employed 131 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 are conducting an informal investigation of us. 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 in connection with a criminal investigation. Based on the information available to us at this time, the inquiries appear to primarily pertain to matters related to portfolio valuation and our portfolio company, Business Loan Express, LLC. To date, we have produced materials in response to requests from both the SEC and the U.S. Attorney's office, and certain current and former employees have provided testimony and have been interviewed by the staff of the SEC and the U.S. Attorney's Office. We are voluntarily cooperating with these investigations.

On May 28, 2004, Ferolie Corporation, a food broker with business and contractual relationships with an entity that is now affiliated with one of our portfolio companies, Advantage Sales & Marketing Inc., filed suit against us, Advantage Sales & Marketing and the affiliated entity in the United States District Court for the District of Columbia alleging that, among other things, we and Advantage Sales & Marketing had tortiously interfered with Ferolie's contract with the affiliated entity by causing the affiliated entity (i) to breach its obligations to Ferolie regarding Ferolie's participation in a reorganization transaction involving the affiliated entity and (ii) to induce clients of Ferolie to transfer their business to the affiliated entity. Ferolie sought actual and punitive damages against us and Advantage Sales & Marketing and declaratory and injunctive relief. On July 15, 2004, the United States District Court for the District of Columbia dismissed the lawsuit for lack of jurisdiction. On August 18, 2004, Ferolie filed a Petition to Compel Arbitration in the United States District Court for the Northern District of Illinois naming us, Advantage Sales & Marketing and the affiliated entity as respondents. Ferolie attached to its petition an Amended Demand for Arbitration and Statement of Claims that asserts essentially the same claims as were asserted in the lawsuit that was dismissed by the United States District Court for the District of Columbia. On October 29, 2004, the United States District Court for the Northern District of Illinois dismissed Ferolie's petition after finding that Ferolie had failed to adequately allege the existence of subject matter jurisdiction.

On November 4, 2004, Ferolie refiled its Petition to Compel Arbitration in the Circuit Court of Cook County, Illinois. The allegations and relief requested in this proceeding were identical to the assertions made by Ferolie in the two previously dismissed

proceedings. On February 15, 2005, the Circuit Court of Cook County, Illinois entered an order denying Ferolie's motion for an order compelling us to arbitrate the claims asserted by Ferolie against us. In the same order, the Circuit Court of Cook County, Illinois granted Ferolie's motion to compel arbitration of the claims asserted against Advantage Sales & Marketing and the affiliated entity. The arbitration is proceeding. We are not a party to the arbitration.

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

While the outcome of these legal proceedings and other matters cannot at this time be predicted with certainty, we do not expect that the outcome of these matters will have a material effect upon our financial condition or results of operations.

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 December 31, 2005. 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 December 31, 2005, at pages F-7 to F-16.

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			
Acme Paging, L.P. ⁽¹⁾ 6080 SW 40th Street, Suite 3 Miami, FL 33155	Paging Services	Common Stock in Affiliate	80.0%
Advantage Sales & Marketing, Inc. ⁽¹⁾⁽⁶⁾ 19100 Von Karman Avenue Suite 600 Irvine, CA 92612	Sales and Marketing Agency	Class A Common Stock	100.0%
Alaris Consulting, LLC ⁽¹⁾⁽²⁾ 360 W. Butterfield Road Suite 400 Elmhurst, IL 60126	Consulting Firm	Equity Interests	100.0%
Avborne, Inc. ⁽¹⁾⁽⁷⁾ c/o Trivest, Inc. 7500 NW 26th Street Miami, FL 33122	Aviation Services	Series B Preferred Stock Common Stock	23.8% 27.2%
Avborne Heavy Maintenance, Inc. ⁽¹⁾⁽⁷⁾ c/o Trivest, Inc. 7500 26th Street N.W. Miami, FL 33122	Aviation Services	Series A Preferred Stock Common Stock	27.5% 27.5%
Business Loan Express, LLC ⁽¹⁾ 1633 Broadway New York, NY 10019	Small Business Lender	Class A Equity Interests Class B Equity Interests Class C Equity Interests Equity Interest in BLX	100.0% 100.0% 94.9%

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Callidus Capital Corporation ⁽¹⁾⁽⁴⁾ 520 Madison Avenue New York, NY 10022	Asset Manager and Finance Company	Subsidiary ⁽³⁾ Common stock	20.0% 100.0%
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Name and Address of Portfolio Company	Nature of its Principal Business	Title of Securities Held by the Company	Percentage of Class Held
Diversified Group Administrators, Inc. 201 Johnson Rd Building #1 Houston, PA 15342	Third Party Administrator for Self-funded Health Benefit Plan	Series B Preferred Stock Series A Preferred Stock Common Stock	64.7% 69.9% 45.8%
Financial Pacific Company ⁽¹⁾ 3455 South 344th Way, Suite 300 Federal Way, WA 98001	Commercial Finance Leasing	Series A Preferred Stock Common Stock	99.4% 99.4%
ForeSite Towers, LLC ⁽¹⁾ 22 Iverness Center Parkway Suite 50 Birmingham, AL 35242	Tower Leasing	Series A Preferred Equity Interest Series B Preferred Equity Interest Series E Preferred Equity Interest Common Equity Interest	100.0% 100.0% 100.0% 77.3%
Global Communications, LLC ⁽¹⁾ 1000 North Dixie Highway West Palm Beach, FL 33401	Muzak Franchisee	Preferred Equity Interest Options for Common Equity Interest	77.8% 59.3%
Gordian Group, Inc. ⁽¹⁾ 499 Park Avenue New York, NY 10022	Financial Advisory Services	Common Stock	100.0%
Healthy Pet Corp. ⁽¹⁾ 1720 Post Road Fairfield, CT 06430	Comprehensive Veterinary Services	Common Stock	99.0%
HMT, Inc. 4422 FM 1960 West Suite 350 Houston, TX 77068	Storage Tank Maintenance & Repair	Class B Preferred Stock Common Stock Warrants to Purchase Common Stock	33.5% 25.0% 9.7%
Impact Innovations Group, LLC 12 Piedmont Center, Suite 210 Atlanta, GA 30305	Information Technology Services Provider	Equity Interest in Affiliate ⁽⁵⁾	50.0%
Insight Pharmaceuticals Corporation ⁽¹⁾ 550 Township Line Road, Suite 300 Blue Bell, PA 19422	Marketer of Over-The- Counter Pharmaceuticals	Preferred Stock Common Stock	100.0% 100.0%
Jakel, Inc. ⁽¹⁾ 400 Broadway Highlands, IL 62249	Manufacturer of Electric Motors and Blowers	Series A-1 Preferred Stock Class B Common Stock	32.3% 100.0%
Legacy Partners Group, LLC ⁽¹⁾ 520 Madison Avenue, 27th Floor New York, NY 10022	Merger and Acquisition Advisor	Equity Interests	100.0%
Litterer Beteiligungs-GmbH Uhlandstrasse 1 69493 Hirschberg Germany	Scaffolding Company	Equity Interest	25.0%

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Mercury Air Centers, Inc. ⁽¹⁾ 1951 Airport Road Atlanta, GA 30341	Fixed Base Operations	Series A Common Stock Common Stock	100.0% 95.0%
MVL Group, Inc. ⁽¹⁾ 1061 E. Indiantown Road Suite 300 Jupiter, FL 33477	Market Research Services	Common Stock	64.9%
Pennsylvania Avenue Investors, L.P. ⁽¹⁾ 1919 Pennsylvania Ave., N.W. Washington, DC 20006	Private Equity Fund	Equity Interests	100.0%
Powell Plant Farms, Inc. ⁽¹⁾ Route 3, Box 1058 Troup, TX 75789	Plant Producer & Wholesaler	Preferred Stock Warrants to Purchase Common Stock	100.0% 83.5%
Redox Brands, Inc. ⁽¹⁾ 9100 Centre Point Drive Suite 200 West Chester, OH 45069	Household Cleaning Products	Series A Convertible Preferred Stock Warrants to Purchase Class A Common Stock	99.2% 8.7%

Name and Address of Portfolio Company	Nature of its Principal Business	Title of Securities Held by the Company	Percentage of Class Held
Service Champ, Inc. ⁽¹⁾ 180 New Britain Boulevard Chalfont, PA 18914	Wholesale Distributor of Auto Parts	Common Stock	63.9%
Staffing Partners Holding Company, Inc. ⁽¹⁾ 104 Church Lane, #100 Baltimore, MD 21208	Temporary Employee Services	Series B Preferred Stock Redeemable Preferred Stock Class A-1 Common Stock Class A-2 Common Stock Class B Common Stock Warrants to purchase Class B Common Stock	71.4% 48.3% 50.0% 24.4% 48.8% 30.3%
Startec Global Communications Corporation ⁽¹⁾ 7631 Calhoun Drive Rockville, MD 20850	Telecommunications Services	Common Stock	68.5%
STS Operating, Inc. (d/b/a SunSource Technology Services, Inc.) ⁽¹⁾ 2301 Windsor Court Addison, IL 60101	Industrial Distribution	Common Stock Options to Purchase Common Stock	77.1% 1.0%
Triview Investments, Inc. ⁽¹⁾⁽¹¹⁾ 1919 Pennsylvania Ave, N.W. Washington, DC 20006	Multi-system Cable Operator and Pharmaceutical Marketer	Common Stock	99.5%
Companies 5% to 25% Owned			
Air Evac Lifeteam 1448 W. Eighth Street West Plains, MO 65775	Air Ambulance Service	Series A Preferred Equity Interest Series B Preferred Equity Interest	6.6% 6.2%
Aspen Pet Products, Inc. 4735 North Florence Street Denver, CO 80238	Pet Product Provider	Series B Preferred Stock Series D Preferred Stock Series A Common Stock Warrants to purchase Series A Common Stock	8.7% 6.5% 6.5% 4.1%
Becker Underwood, Inc. 801 Dayton Avenue Ames, IA 50010	Speciality Chemical Manufacturer	Common Stock	6.1%
The Debt Exchange Inc. ⁽¹⁾ 101 Arch Street, Suite 410 Boston, MA 02110	Online Sales of Financial Assets	Series B Convertible Preferred Stock	40.0%
MedBridge Healthcare, LLC ⁽¹⁾ 110 West North Street, Suite 100 Greenville, SC 29601	Sleep Diagnostic Facilities	Debt Convertible into Equity Interests	75.0%
Nexcel Synthetics, LLC 6076 Southern Industrial Drive	Manufacturer of Carpet Backing	Class A Equity Interest Class B Equity Interest	6.8% 6.8%

Birmingham, AL 35235 Pres Air Trol LLC 1009 W. Boston Post Road Mamaroneck, NY 10543	Pressure Switch Manufacturer	Class A Equity Interests	32.8%
Progressive International Corporation 6111 S. 228th Street Kent, WA 98064	Retail Kitchenware	Series A Redeemable Preferred Stock Class A Common Stock Warrants to Purchase Class A Common Stock	12.5% 1.0% 42.0%
Soteria Imaging Services, LLC 6009 Brownsboro Park Blvd., Suite H Louisville, KY 40207	Diagnostic Imaging Facilities Operator	Class A Preferred Equity Interest	10.8%

Name and Address of Portfolio Company	Nature of its Principal Business	Title of Securities Held by the Company	Percentage of Class Held
Universal Environmental Services, LLC 411 Dividend Drive Peachtree City, GA 30269	Used Oil Recycling	Preferred Equity Interests	15.0%
Companies Less Than 5% Owned			
Advanced Circuits, Inc. 30 South Wacker Drive, Suite 3700 Chicago, IL 60606	Printed Circuit Boards Manufacturer	Common Stock	3.0%
Benchmark Medical, Inc. 101 Lindin Drive, Suite 420 Malvern, PA 19355	Outpatient Physical Therapy Services	Warrant to Purchase Common Stock	2.5%
Border Foods, Inc. 1750 Valley View Lane, Suite 350 Farmer s Branch, TX 75234	Mexican Ingredient & Food Product Manufacturer	Series A Preferred Stock Series B-2 Preferred Stock Warrants to Purchase Series B-2 Preferred Stock Common Stock Warrants to Purchase Common Stock	9.4% 100.0% 100.0% 12.4% 73.8%
Callidus Debt Partners CLO Fund III, Ltd. ⁽⁸⁾ 135 Lasalle Street Chicago, IL 60694	Senior Debt Fund	Preferred Shares	68.4%
Camden Partners Strategic Fund II, L.P. One South Street Suite 2150 Baltimore, MD 21202	Private Equity Fund	Limited Partnership Interest	3.9%
Catterton Partners V, L.P. 7 Greenwich Office Park Greenwich, CT 06830	Private Equity Fund	Limited Partnership Interest	0.8%
Component Hardware Group, Inc. 1890 Swarthmore Ave. Lakewood, NJ 08701	Designer & Developer of Hardware Components	Class A Preferred Stock Class B Common Stock	7.4% 13.5%
Cooper Natural Resources, Inc. P.O. Box 1477 Seagraves, TX 79360	Sodium Sulfate Producer	Series A Convertible Preferred Stock Warrants to Purchase Series A Convertible Preferred Stock Warrants to Purchase Common Stock	100.0% 36.8% 6.5%
Coverall North America, Inc. 5201 Congress Avenue, Suite 275 Boca Raton, FL 33487	Contract Cleaning Services	Preferred Stock Warrant to Purchase Common Stock	100.0% 21.4%
eCentury Capital Partners, L.P.	Private Equity Fund	Limited Partnership	

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8270 Greensboro Drive Suite 1025 McLean, VA 22102		Interest	25.0%
Elexis Beta GmbH Ulmenstraße 22 60325 Frankfurt am Main Germany	Distance Measurement Device Manufacturer	Options to Purchase Shares	9.8%
Frozen Specialties, Inc. 720 Barre Road Archbold, OH 43502	Private Label Frozen Food Manufacturer	Warrants to Purchase Class A Common Stock	2.7%
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	8.4% 8.4%

Name and Address of Portfolio Company	Nature of its Principal Business	Title of Securities Held by the Company	Percentage of Class Held
Grotech Partners, VI, L.P. c/o Grotech Capital Group 9690 Deereco Road Suite 800 Timonium, MD 21093	Private Equity Fund	Limited Partnership Interest	2.4%
Havco Wood Products LLC P.O. BOX 1342 Cape Girardeau, MO 63702	Hardwood Flooring Products Manufacturer	Equity Interests	4.5%
Homax Holdings, Inc. 468 West Horton Road Bellingham, WA 98226	Supplier of Branded Consumer Products	Preferred Stock Common Stock Warrant to Purchase Preferred Stock Warrant to Purchase Common Stock	0.1% 0.1% 1.1% 1.1%
Icon International, Inc. 281 Tressor Boulevard 8th Floor Stamford, CT 06901	Corporate Barter Services	Class C Common Stock	2.0%
International Fiber Corporation 50 Bridge Street North Tonawanda, NY 14120	Cellulose and Fiber Producer	Series A Preferred Stock	4.7%
MedAssets, Inc. 100 Northpoint Center East #150 Alpharetta, GA 30022	Healthcare Outsourcing	Series B Convertible Preferred Stock Warrants to Purchase Common Stock	7.8% 0.6%
Meineke Car Care Centers, Inc. 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	99.6% 51.0%
MHF Logistical Solutions, Inc. 800 Cranberry Woods Drive Suite 450 Cranberry Township, PA 16066	Third-Party Environmental Logistics	Series A Preferred Stock Common Stock	3.6% 3.6%
Mid-Atlantic Venture Fund IV, L.P. 128 Goodman Drive Bethlehem, PA 18015	Private Equity Fund	Limited Partnership Interest	6.7%
Mogas Energy, LLC 13137 Thunderhead Falls Lane	Natural Gas Pipeline Operator	Warrants to Purchase Equity Interests	20.0%

Rapid City, SD 57702			
Network Hardware Resale, Inc.	Provider of Pre-Owned Networking Equipment	Debt Convertible into Common Stock	 21.8%
26 Castilian Drive, Suite A			
Santa Barbara, CA 93117			
Nobel Learning Communities, Inc.	Educational Services	Series D Preferred Stock	100.0%
1400 N. Providence Road		Series F Convertible Preferred Stock	25.6%
Suite 3055		Warrants to Purchase Common Stock	6.6%
Media, PA 19063			
Norwesco, Inc.	Polyethylene Tanks Manufacturer	Class B Nonvoting Common Stock	96.3%
P.O. BOX 439		Warrants to Purchase Class A Common Stock	50.2%
4365 Steiner St.			
St. BoniFacijs, MN 55375			
Novak Biddle Venture Partners III, L.P.	Private Equity Fund	Limited Partnership Interest	2.5%
7501 Wisconsin Avenue			
East Tower, Suite 1380			
Bethesda, MD 20814			
Opinion Research Corporation	Corporate Marketing Research Firm	Warrants to Purchase Common Stock	6.4%
P.O. Box 183			
Princeton, NJ 08542			

Name and Address of Portfolio Company	Nature of its Principal Business	Title of Securities Held by the Company	Percentage of Class Held
Oriental Trading Company, Inc. 108th Street, 4206 South Omaha, NE 68137	Direct Marketer of Toys	Class A Common Stock	1.7%
Palm Coast Data, LLC 11 Commerce Blvd Palm Coast, FL 32164	Magazines and Subscribers Relationship Management	Class B Common Stock Warrants to Purchase Class A Common Stock	100.0% 56.9%
Performant Financial Corporation 333 N. Canyon Pkwy Suite 100 Livermore, CA 94551	Collections and Default Prevention Services	Common Stock	2.9%
Pro Mach, Inc. 1000 Abernathy Road, Suite 1110 Atlanta, GA 30328	Packaging Machinery Manufacturer	Equity Interests	2.3%
S.B. Restaurant Company (d/b/a Elephant Bar) 6326-A Lindmar Drive Goleta, CA 93117	Restaurants	Series B Convertible Preferred Stock Warrant to Purchase Series A Common Stock	2.5% 13.1%
SBBUT, LLC 52 River Road Stowe, VT 05672	Holding Company	Equity Interests in Affiliate Company	10.4%
Soff-Cut Holdings, Inc. 1112 Olympic Drive Corona, CA 91719	Concrete Sawing Equipment Manufacturer	Series A Preferred Stock Common Stock	14.3% 2.7%
SPP Mezzanine Fund, L.P. 330 Madison Avenue, 28th Floor New York, NY 10017	Private Equity Fund	Limited Partnership Interest	35.7%
Tradesmen International, Inc. 9760 Shepard Road Macedonia, OH 44056	Outsourced Skilled Construction Craftsmen	Warrant to Purchase Common Stock	4.5%
TransAmerican Auto Parts, LLC 801 West Artesia Blvd Compton, CA 90220	Auto Parts and Accessories Retailer and Wholesaler	Preferred Equity Interests Common Equity Interests	1.4% 1.4%
United Site Services, Inc. 200 Friberg Parkway, Suite 4000 Westborough, MA 01582	Portable Rest Room Services	Common Stock	1.3%
Udata Venture Partners II, L.P. 11600 Sunrise Valley Drive	Private Equity Fund	Limited Partnership Interest	15.0%

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Venturehouse-Cibernet Investors, LLC 509 Seventh Street, NW Washington, DC 20004	Third-Party Billing	Equity Interest	3.3%
Venturehouse Group, LLC 1780 Tysons Boulevard, Suite 400 McLean, VA 22102	Private Equity Fund	Common Equity Interest	3.1%
VICORP Restaurants, Inc. 400 W. 48th Avenue Denver, CO 80216	Restaurants	Warrant to Purchase Preferred Stock Warrant to Purchase Common Stock	1.0% 3.4%
Walker Investment Fund II, LLLP 3060 Washington Road Suite 200 Glenwood, MD 21738	Private Equity Fund	Limited Partnership Interest	5.1%

Name and Address of Portfolio Company	Nature of its Principal Business	Title of Securities Held by the Company	Percentage of Class Held
Wear Me Apparel Corporation 31 West 34th Street New York, NY 10001	Marketer of Children's Apparel	Warrant to Purchase Common Stock	2.0%
Wilshire Restaurant Group, Inc. 1100 Town & Country Road Suite 1300 Orange, CA 92868-4654	Restaurants	Warrants to Purchase Preferred Stock Warrants to Purchase Common Stock	14.2% 14.2%
Woodstream Corporation 69 North Locust Street Lititz, PA 17543	Pest Control Manufacturer	Common Stock Warrants to Purchase Common Stock	4.4% 3.7%
COMMERCIAL REAL ESTATE FINANCE⁽⁹⁾			
8830 Macon Highway Holding Company, LLC ⁽¹⁾ 1919 Pennsylvania Ave, N.W. Washington, DC 20006	Mobile Home Park	Equity Interests	100.0%
WSALD-CEH, LLC ⁽¹⁾	Commercial Real	Equity Interest	50.0%