ALLIED CAPITAL CORP
Form 497
July 23, 2001

1

PROSPECTUS SUPPLEMENT
(To Prospectus dated May 24, 2001)

Filed Pursuant to Rule 497
Registration Statement No. 333-43534

1,091,878 SHARES

[ALLIED CAPITAL LOGO]
COMMON STOCK

All of the 1,091,878 shares of the common stock, par value $.0001 per share, of Allied Capital Corporation are being issued and sold by us to an institutional investor at negotiated purchase prices for total offering proceeds to the Company of $25 million.

These negotiated purchase prices, per share, are equal to the Volume Weighted Average Price on the Nasdaq National Market, as reported by Bloomberg L.P. using the AQR function for the shares (the "Average Trading Price"), less a discount of 4.0% (the "Purchase Price"), for each of the fifteen trading days during the period from June 29, 2001 to July 20, 2001 (the "Investment Period").

The total number of shares offered hereby equals the aggregate number of shares resulting from:

(i) the allocation of the purchaser's proposed aggregate investment of $25 million on a pro rata basis over the Investment Period; and

(ii) the purchase, on each day during the Investment Period on which the Average Trading Price exceeds $20.00 (the "Threshold Price") or on which the Average Trading Price is below the Threshold Price and the purchaser chooses to purchase shares at the Threshold Price, of the maximum number of whole shares at the Purchase Price. The price to be paid will be reduced by the dividend amount if there is an ex-dividend date during the Investment Period.

This results in the purchase of a total of 1,091,878 shares at an average purchase price per share of $22.8963.

Our common stock is traded on the New York Stock Exchange under the symbol "ALD." On July 20, 2001, the last reported sales price for the common stock was $23.95.

We are an internally managed closed-end management investment company that has elected to be regulated as a business development company under the Investment Company Act of 1940, as amended. Our investment objective is to achieve current income and capital gains.

Please read this prospectus supplement, and the accompanying prospectus, before investing, and keep it for future reference. It contains important information about the Company. To learn more about the Company, you may want to look at the Statement of Additional Information dated May 24, 2001 (known as the "SAI"). For a free copy of the SAI, contact us at Allied Capital Corporation, 1919 Pennsylvania Avenue, N.W., Washington, DC 20006, 1-888-818-5298. We have filed the SAI with the U.S. Securities and Exchange Commission and have

incorporated it by reference into the prospectus. The SAI's table of contents appears on page 78 of the prospectus. The Commission maintains an Internet website (http://www.sec.gov) that contains the SAI, material incorporated by reference and other information about the Company.

YOU SHOULD REVIEW THE INFORMATION INCLUDING THE RISK OF LEVERAGE, SET FORTH UNDER "RISK FACTORS" ON PAGE 8 OF THE PROSPECTUS, BEFORE INVESTING IN COMMON STOCK OF THE COMPANY.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR PASSED UPON THE ADEQUACY OR ACCURACY OF THIS PROSPECTUS SUPPLEMENT OR THE PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

July 20, 2001

2

WE HAVE NOT AUTHORIZED ANY DEALER, SALESPERSON OR OTHER PERSON TO GIVE ANY INFORMATION OR TO MAKE ANY REPRESENTATION OTHER THAN THOSE CONTAINED OR INCORPORATED BY REFERENCE IN THIS PROSPECTUS SUPPLEMENT OR THE PROSPECTUS. YOU MUST NOT RELY UPON ANY INFORMATION OR REPRESENTATION NOT CONTAINED OR INCORPORATED BY REFERENCE IN THIS PROSPECTUS SUPPLEMENT OR THE PROSPECTUS AS IF WE HAD AUTHORIZED IT. THIS PROSPECTUS SUPPLEMENT AND THE PROSPECTUS 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 SUPPLEMENT AND THE PROSPECTUS IS ACCURATE AS OF THE DATES ON THEIR COVERS.

TABLE OF CONTENTS

	PAGE
PROSPECTUS SUPPLEMENT	
Fees and Expenses..	S-1
Use of Proceeds..	S-2
Plan of Distribution.....................................	S-2
PROSPECTUS	
Prospectus Summary.......................................	1
Selected Consolidated Financial Data.....................	5
Risk Factors...	8
The Company..	13
Use of Proceeds..	13
Price Range of Common Stock and Distributions............	14
Management's Discussion and Analysis of Financial Condition and Results of Operations..............................	15
Senior Securities..	35
Business...	39
Portfolio Companies......................................	50
Determination of Net Asset Value.........................	56
Management...	57
Tax Status...	64
Certain Government Regulations...........................	69
Dividend Reinvestment Plan...............................	71
Description of Securities................................	72

Plan of Distribution	76
Legal Matters	77
Safekeeping, Transfer and Dividend Paying Agent and Registrar	77
Independent Public Accountants	77
Table of Contents of Statement of Additional Information	78
Index to Financial Statements	79

INFORMATION CONTAINED OR INCORPORATED BY REFERENCE IN THIS PROSPECTUS SUPPLEMENT, AND THE PROSPECTUS, MAY CONTAIN "FORWARD-LOOKING STATEMENTS" WHICH CAN BE IDENTIFIED BY THE USE OF FORWARD-LOOKING TERMINOLOGY SUCH AS "MAY," "WILL," "EXPECT," "INTEND," "ANTICIPATE," "ESTIMATE," OR "CONTINUE" OR THE NEGATIVE THEREOF OR OTHER VARIATIONS THEREON OR COMPARABLE TERMINOLOGY. THE MATTERS DESCRIBED IN "RISK FACTORS" IN THE PROSPECTUS AND CERTAIN OTHER FACTORS NOTED THROUGHOUT THIS PROSPECTUS SUPPLEMENT AND THE PROSPECTUS, AND IN ANY EXHIBITS TO THE REGISTRATION STATEMENT OF WHICH THIS PROSPECTUS SUPPLEMENT AND THE PROSPECTUS ARE 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. IN THIS PROSPECTUS SUPPLEMENT AND THE PROSPECTUS, UNLESS OTHERWISE INDICATED, THE "COMPANY", "WE", "US" OR "OUR" REFER TO ALLIED CAPITAL CORPORATION AND ITS SUBSIDIARIES.

3

FEES AND EXPENSES

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

SHAREHOLDER TRANSACTION EXPENSES	
Privately negotiated transaction (as a percentage of offering price)(1)	4.0%
Dividend reinvestment plan fees(2)	None
ANNUAL EXPENSES (AS A PERCENTAGE OF CONSOLIDATED NET ASSETS ATTRIBUTABLE TO COMMON SHARES)(3)	
Operating expenses(4)	4.1%
Interest payments on borrowed funds(5)	6.9%
Total annual expenses(6)	11.0%

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(1) The discount with respect to the shares sold by the Company in this offering is the only sales load paid in connection with this offering.

(2) The expenses of the Company's DRIP plan are included in "Operating expenses." The Company has no cash purchase plan. The participants in the DRIP plan will bear a pro rata share of brokerage commissions incurred with respect to open market purchases, if any. See "Dividend Reinvestment Plan" in the prospectus.

(3) "Consolidated net assets attributable to common shares" equals net assets (i.e., total assets less total liabilities and preferred stock) at March 31, 2001.

(4) "Operating expenses" represent the estimated operating expenses of the Company for the year ending December 31, 2001 excluding interest on indebtedness.

(5) The "Interest payments on borrowed funds" represent estimated interest payments for the year ending December 31, 2001 divided by consolidated net assets attributable to common stock at March 31, 2001. The Company had outstanding borrowings of $883.8 million at March 31, 2001. This percentage for the year ended December 31, 2000 was 5.6%. See "Risk Factors" in the prospectus.

(6) "Total annual expenses" as a percentage of consolidated net assets attributable to common stock are higher than the total annual expenses percentage would be for a company that is not leveraged. The Company borrows money to leverage its net assets and to increase its total assets. The Securities and Exchange Commission requires that "Total annual expenses" percentage be calculated as a percentage of net assets, rather than the total assets, including assets that have been funded with borrowed money. If the "Total annual expenses" percentage were calculated instead as a percentage of consolidated total assets, "Total annual expenses" for the Company would be 5.9% of consolidated total assets.

EXAMPLE

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

	1 YEAR	3 YEARS	5 YEARS	10 YEA
You would pay the following expenses on a $1,000 investment, assuming a 5% annual return..............................	$147	$360	$568	$1,07

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

THE EXAMPLE SHOULD NOT BE CONSIDERED A REPRESENTATION OF FUTURE EXPENSES, AND THE ACTUAL EXPENSES MAY BE GREATER OR LESS THAN THOSE SHOWN.

USE OF PROCEEDS

The net proceeds from the sale of the shares, after deducting estimated expenses of this offering, are approximately $24.9 million. We intend to use the net proceeds from selling shares to finance our Company's growth and for general corporate purposes, which may include investment in private growth companies, purchase of commercial mortgage-backed securities and acquisitions. We may also repay a portion of our revolving line of credit.

We raise new equity from time to time using a shelf registration statement. We raise new equity when we have a clear use of proceeds for attractive investment opportunities. Historically, this process has enabled us to raise

equity on an accretive basis for existing shareholders.

PLAN OF DISTRIBUTION

All of the 1,091,878 shares of common stock, par value $0.0001 per share, that we are offering by this prospectus supplement and the accompanying prospectus are being issued and sold to an institutional investor at negotiated purchase prices for total offering proceeds to the Company of $25 million.

These negotiated purchase prices, per share, are equal to the Volume Weighted Average Price on the Nasdaq National Market, as reported by Bloomberg L.P. using the AQR function for the shares (the "Average Trading Price"), less a discount of 4.0% (the "Purchase Price"), for each of the fifteen trading days during the period from June 29, 2001 to July 20, 2001 (the "Investment Period"). The total number of shares offered hereby equals the aggregate number of shares resulting from:

(i) the allocation of the purchaser's proposed aggregate investment of $25 million on a pro rata basis over the Investment Period, and

(ii) the purchase, on each day during the Investment Period on which the Average Trading Price exceeds $20.00 (the "Threshold Price") or on which the Average Trading Price is below the Threshold Price and the purchaser chooses to purchase shares at the Threshold Price, of the maximum number of whole shares at the Purchase Price. The price to be paid will be reduced by the dividend amount in the event of an ex-dividend date between the starting date of the Investment Period and the date on which the number of shares are received. This results in the purchase of a total of 1,091,878 shares at an average purchase price per share of $22.8963.

The net offering proceeds to us, after deduction of estimated offering expenses of approximately $50,000, will be approximately $24.9 million.

PROSPECTUS

$310,500,000

[ALLIED CAPITAL LOGO]

COMMON STOCK
PREFERRED STOCK
DEBT SECURITIES

Please read this prospectus, and the accompanying prospectus supplement, if any, before investing, and keep it for future reference. It contains important information about the Company.

To learn more about the Company, you may want to look at the Statement of Additional Information dated May 24, 2001 (known as the "SAI"). For a free copy of the SAI, contact us at:

Allied Capital Corporation
1919 Pennsylvania Avenue, N.W.
Washington, DC 20006
1-888-818-5298

The Company has filed the SAI with the U.S. Securities and Exchange Commission and has incorporated it by reference into this prospectus. The SAI's table of contents appears on page 70 of this prospectus.

The Commission maintains an Internet website (http://www.sec.gov) that contains the SAI, material incorporated by reference and other information about the Company.

Our common stock is traded on the Nasdaq National Market under the symbol "ALLC." As of June 6, 2001, our common stock will be traded on the New York Stock Exchange under the symbol "ALD." As of May 23, 2001, the last reported sales price on the Nasdaq National Market for the common stock was $24.62.

We may offer, from time to time, up to $310,500,000 of our common stock, par value $0.0001 per share, preferred stock, or debt securities in one or more offerings. All shares of common stock, preferred stock, and debt securities that are offered under this prospectus are collectively referred to herein as the "Securities."

The Securities may be offered at prices and on terms to be described in one or more supplements to this prospectus. In the case of our common stock, the offering price per share less any underwriting commissions or discounts will not be less than the net asset value per share of our common stock at the time we make the offering.
We are an internally managed closed-end management investment company that has elected to be regulated as a business development company under the Investment Company Act of 1940, as amended.

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

YOU SHOULD REVIEW THE INFORMATION INCLUDING THE RISK OF LEVERAGE, SET FORTH UNDER "RISK FACTORS" ON PAGE 8 OF THIS PROSPECTUS BEFORE INVESTING IN SECURITIES OF THE COMPANY.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR PASSED UPON THE ADEQUACY OR ACCURACY OF THIS PROSPECTUS. ANY REPRESENTATIONS TO THE CONTRARY IS A CRIMINAL OFFENSE.

THIS PROSPECTUS MAY NOT BE USED TO CONSUMMATE SALES OF SECURITIES UNLESS ACCOMPANIED BY A PROSPECTUS SUPPLEMENT.

May 24, 2001

6

WE HAVE NOT AUTHORIZED ANY DEALER, SALESMAN OR OTHER PERSON TO GIVE ANY INFORMATION OR TO MAKE ANY REPRESENTATION OTHER THAN THOSE CONTAINED OR INCORPORATED BY REFERENCE IN THIS PROSPECTUS OR ANY ACCOMPANYING SUPPLEMENT TO THIS PROSPECTUS. YOU MUST NOT RELY UPON ANY INFORMATION OR REPRESENTATION NOT CONTAINED OR INCORPORATED BY REFERENCE IN THIS PROSPECTUS OR THE ACCOMPANYING PROSPECTUS SUPPLEMENT AS IF WE HAD AUTHORIZED IT. THIS PROSPECTUS AND ANY PROSPECTUS SUPPLEMENT 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 PROSPECTUS SUPPLEMENT IS ACCURATE AS OF THE DATES ON THEIR COVERS.

TABLE OF CONTENTS

	PAGE
Prospectus Summary	1
Selected Consolidated Financial Data	5
Risk Factors	8
The Company	13
Use of Proceeds	13
Price Range of Common Stock and Distributions	14
Management's Discussion and Analysis of Financial Condition and Results of Operations	15
Senior Securities	35
Business	39
Portfolio Companies	50
Determination of Net Asset Value	56
Management	57
Tax Status	64
Certain Government Regulations	69
Dividend Reinvestment Plan	71
Description of Securities	72
Plan of Distribution	76
Legal Matters	77
Safekeeping, Transfer and Dividend Paying Agent and Registrar	77
Independent Public Accountants	77
Table of Contents of Statement of Additional Information	78
Index to Financial Statements	79

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 document and the documents to which we have referred.

Our current business and investment portfolio resulted from the merger of five affiliated companies on December 31, 1997. The companies that merged were Allied Capital Corporation (old), Allied Capital Corporation II, Allied Capital Advisers, Inc. ("Advisers"), Allied Capital Commercial Corporation and Allied Capital Lending Corporation. The five companies are referred to as the predecessor companies.

All information in this prospectus, unless otherwise indicated, has been presented as if the predecessor companies had merged as of the beginning of the earliest period presented. In this prospectus or any accompanying prospectus supplement, unless otherwise indicated, the "Company", "ACC", "we", "us" or "our" refer to the post-merger Allied Capital Corporation and its subsidiaries.

THE COMPANY (Page 13)

We are a business development company and provide private investment capital to private and undervalued public companies in a variety of different industries throughout the United States. We have been investing in growing businesses for over 40 years and have financed thousands of companies nationwide. As of January 2001, our investment activity is focused in two areas:

- private finance, and
- commercial real estate finance, primarily the purchase of commercial mortgage-backed securities ("CMBS").

Our investment portfolio includes:

- long-term unsecured loans with equity features,
- commercial mortgage-backed securities, and
- commercial mortgage loans.

We identify loans and investments through our numerous relationships with:

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

In order to increase our sourcing and origination activities, we have two regional offices in New York and Chicago. We centralize our credit approval function and service our loans through an experienced staff of professionals at our headquarters in Washington, DC.

We have an advantageous tax structure, as compared to operating companies, that allows for the "pass-through" of income to our shareholders through dividends without the imposition of a corporate level of taxation. See "Tax Status."

We are an internally managed diversified closed-end management investment company that has elected to be regulated as a business development company ("BDC") under the Investment Company Act of 1940, as amended ("1940 Act"). Our investment objective is to achieve current income and capital gains. We seek to achieve our investment objective by investing in growing businesses in a variety of industries throughout the United States. As a BDC, we are required to meet regulatory tests, the most significant relating to its investments and borrowings. A BDC is required to invest at least 70%

of its assets in private or thinly traded public, U.S.-based companies. A BDC must maintain a coverage ratio of assets to senior securities of at least 200%. See "Business -- Certain Government Regulations."

We are quoted on the Nasdaq National Market and trade under the symbol "ALLC." Beginning on June 6, 2001, our stock will be listed on the New York Stock Exchange and will trade under the symbol "ALD."

THE OFFERING (Page 76)

We may offer, from time to time, up to $310,500,000 of our Securities, on terms to be determined at the time of offering.

Securities may be offered at prices and on terms described in one or more supplements to this prospectus. In the case of the offering of our common stock, the offering price per share less any underwriting commission or discount will not be less than the net asset value per share of our common stock at the time we make the offering.

Our 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 supplement to this prospectus relating to the offering will identify any agents or underwriters involved in the sale of our Securities, and will set forth any applicable purchase price, fee and commission or discount arrangement between our agents and us or among our underwriters or the basis upon which such amount may be calculated.

We may not sell Securities without delivering a prospectus supplement describing the method and terms of the offering of our Securities.

USE OF PROCEEDS (Page 13)

Unless otherwise specified in the prospectus supplement accompanying this prospectus, we intend to use the net proceeds from selling Securities for general corporate purposes, which may include investments in private and undervalued public companies, purchase of CMBS, repayment of indebtedness, acquisitions and other general corporate purposes.

DISTRIBUTIONS (Page 14)

We pay quarterly dividends to holders of our common stock. The amount of our quarterly dividends is determined by the board of directors. Other types of Securities will likely pay distributions in accordance with their terms.

DIVIDEND REINVESTMENT PLAN (Page 71)

We have adopted an "opt out" dividend reinvestment plan ("DRIP plan") for our common stockholders. Under the DRIP plan, if your shares of common stock are registered in your name, your dividends will be automatically reinvested in additional shares of our common stock unless you "opt out" of the DRIP plan.

PRINCIPAL RISK FACTORS (Page 8)

Investment in Securities involves certain risks relating to our structure and our investment objective that you should consider before purchasing Securities.

As a BDC, our consolidated portfolio includes securities primarily issued by privately held companies. These investments may involve a high degree of business and financial risk, and they are generally illiquid. A large number of entities and individuals compete for the same kind of investment opportunities as we do.

We borrow funds to make investments in private businesses. 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.

Also, we are subject to certain risks associated with investing in non-investment grade CMBS, valuing our portfolio, changing interest rates,

accessing additional capital, fluctuating quarterly results, and operating in a regulated environment. In addition, the loss of pass-through tax treatment could have a material adverse effect on our total return, if any.

CERTAIN ANTI-TAKEOVER PROVISIONS (Page 73)

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

FEES AND EXPENSES

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

SHAREHOLDER TRANSACTION EXPENSES	
Sales load (as a percentage of offering price)(1).......	--%
Dividend reinvestment plan fees(2)......................	None
ANNUAL EXPENSES (AS A PERCENTAGE OF CONSOLIDATED NET ASSETS ATTRIBUTABLE TO COMMON STOCK)(3)	
Operating expenses(4)..................................	4.1%
Interest payments on borrowed funds(5)..................	6.9%
Total annual expenses(6)..........................	11.0%

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

(2) The expenses of the Company's DRIP plan are included in "Operating expenses." The Company has no cash purchase plan. The participants in the DRIP plan will bear a pro rata share of brokerage commissions incurred with respect to open market purchases, if any. See "Dividend Reinvestment Plan."

(3) "Consolidated net assets attributable to common stock" equals net assets (i.e., total assets less total liabilities and preferred stock) at March 31, 2001.

(4) "Operating expenses" represent the estimated operating expenses of the Company for the year ending December 31, 2001 excluding interest on indebtedness.

(5) The "Interest payments on borrowed funds" percentage is based on estimated interest payments for the year ending December 31, 2001 divided by consolidated net assets attributable to common stock at March 31, 2001. The Company had outstanding borrowings of $883.8 million at March 31, 2001. This percentage for the year ended December 31, 2000 was 5.6%. See "Risk Factors."

(6) "Total annual expenses" as a percentage of consolidated net assets

attributable to common stock are higher than the total annual expenses percentage would be for a company that is not leveraged. The Company borrows money to leverage its net assets and increase its total assets. The Securities and Exchange Commission requires that "Total annual expenses" percentage be calculated as a percentage of net assets, rather than the total assets, including assets that have been funded with borrowed monies. If the "Total annual expenses" percentage were calculated instead as a percentage of consolidated total assets, "Total annual expenses" for the Company would be 5.9% of consolidated total assets.

EXAMPLE

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

	1 YEAR	3 YEARS	5 YEARS	10 YEARS
You would pay the following expenses on a $1,000 investment, assuming a 5.0% annual return........	$110	$326	$539	$1,055

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

THE EXAMPLE SHOULD NOT BE CONSIDERED A REPRESENTATION OF FUTURE EXPENSES, AND THE ACTUAL EXPENSES MAY BE GREATER OR LESS THAN THOSE SHOWN.

4

11

SELECTED CONSOLIDATED FINANCIAL DATA

You should read the consolidated financial information below with the Consolidated Financial Statements and Notes thereto included in this prospectus. Financial information for the years ended December 31, 2000, 1999, 1998, 1997 and 1996 has been derived from audited financial statements. On December 31, 1997, the Company consummated a merger of five predecessor companies. The selected financial data reflects the operations of the Company with all periods restated as if the predecessor companies had merged as of the beginning of the earliest period presented. Quarterly financial information is derived from unaudited financial data, but in the opinion of management, reflects all adjustments (consisting only of normal recurring adjustments) which are necessary to present fairly the results for such interim periods. Interim results at and for the three months ending March 31, 2001 are not necessarily indicative of the results that may be expected for the year ending December 31, 2001. SEE "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS" ON PAGE 15 FOR MORE INFORMATION.

(IN THOUSANDS, EXCEPT PER SHARE DATA)	THREE MONTHS ENDED MARCH 31,		YEAR ENDED DECEMBER 31			
	2001	2000	2000	1999	1998	1
	(UNAUDITED)					
OPERATING DATA:						
Interest and related portfolio income:						
Interest and dividends..............	$54,875	$38,812	$182,307	$121,112	$ 80,281	$8
Premiums from loan dispositions.....	821	3,289	16,138	14,284	5,949	
Post-merger gain on securitization of commercial mortgage loans......	--	--	--	--	14,812	
Investment advisory fees and other income...........................	9,375	1,796	13,144	5,744	5,696	
Total interest and related portfolio income..............	65,071	43,897	211,589	141,140	106,738	9
EXPENSES:						
Interest............................	15,930	12,311	57,412	34,860	20,694	2
Employee............................	6,418	4,569	19,842	16,136	11,829	1
Administrative......................	2,967	2,753	15,435	12,350	11,921	
Merger..............................	--	--	--	--	--	
Total operating expenses........	25,315	19,633	92,689	63,346	44,444	5
Formula and cut-off awards(1).......	28	1,691	6,183	6,753	7,049	
Net operating income before net realized and unrealized gains.....	39,728	22,573	112,717	71,041	55,245	4
Net realized and unrealized gains:						
Net realized gains..................	1,154	2,176	15,523	25,391	22,541	1
Net unrealized gains (losses).......	11,146	4,832	14,861	2,138	1,079	
Total net realized and unrealized gains..............	12,300	7,008	30,384	27,529	23,620	1
Income before minority interests and income taxes.........................	52,028	29,581	143,101	98,570	78,865	6
Minority interests.....................	--	--	--	--	--	
Income tax expense.....................	--	--	--	--	787	
Net increase in net assets resulting from operations.....................	$52,028	$29,581	$143,101	$ 98,570	$ 78,078	$6

	THREE MONTHS ENDED MARCH 31,		YEAR ENDED DECEMBER 31,			
	2001	2000	2000	1999	1998	1997
	(UNAUDITED)					
PER SHARE:						
Diluted net operating income per						

common share(2)..................	$ 0.46	$ 0.34	$ 1.53	$ 1.18	$ 1.06	$ 1.04
Diluted earnings per common share...	$ 0.60	$ 0.45	$ 1.94	$ 1.64	$ 1.50	$ 1.24
Dividends per common share(3).......	$ 0.49	$ 0.45	$ 1.82	$ 1.60	$ 1.43	$ 1.71
Weighted average common shares outstanding - diluted(4)..........	87,059	66,308	73,472	60,044	51,974	49,251

5

12

(IN THOUSANDS, EXCEPT PER SHARE DATA)	AT MARCH 31,	AT DECEMBER 31,			
	2001	2000	1999	1998	1997
	(UNAUDITED)				
BALANCE SHEET DATA:					
Portfolio at value.............	$1,886,753	$1,788,001	$1,228,497	$807,119	$703,331
Portfolio at cost..............	1,852,745	1,765,895	1,222,901	803,479	697,030
Total assets...................	1,973,498	1,853,817	1,290,038	856,079	807,775
Total debt outstanding(5).......	883,776	786,648	592,850	334,350	347,663
Preferred stock issued to SBA(5)........................	7,000	7,000	7,000	7,000	7,000
Shareholders' equity...........	1,054,245	1,029,692	667,513	491,358	420,060
Shareholders' equity per common share (NAV)..................	$ 12.26	$ 12.11	$ 10.20	$ 8.79	$ 8.07
Common shares outstanding at period end(4)................	85,956	85,057	65,414	55,919	52,047

	THREE MONTHS ENDED MARCH 31,		YEAR ENDED DECEMBER 31,			
	2001	2000	2000	1999	1998	1997
	(UNAUDITED)					
OTHER DATA:						
New portfolio investments....	$150,758	$218,308	$901,545	$751,871	$524,530	$364,942
Loan repayments..............	26,552	53,431	154,112	145,706	138,081	233,005
Loan sales(6)................	35,187	39,628	280,244	198,368	81,013	53,912
Realized gains...............	1,900	2,669	28,604	31,536	25,757	15,804
Realized losses..............	(746)	(493)	(13,081)	(6,145)	(3,216)	(5,100)

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(1) See "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Results of Operations -- Comparison of Three Months Ended March 31, 2001 and 2000 and Fiscal Years Ended December 31, 2000, 1999, and 1998."

(2) Diluted net operating income per common share for the year ended December 31, 1997 excludes merger expenses.

(3) Distributions are based on taxable income, which differs from income for financial reporting purposes. In 1997, Allied Capital Corporation (old) distributed $0.34 per common share representing the 844,914 shares of Allied Capital Lending Corporation distributed in conjunction with the merger. The

distribution resulted in a partial return of capital. Also in conjunction with the merger, the Company distributed $0.17 per common share representing the undistributed earnings of the predecessor companies at December 31, 1997.

(4) Excludes 268,030 common shares held in the deferred compensation trust at or for the three months ended March 31, 2000, and 234,977, 516,779 and 810,456 common shares held in the deferred compensation trust at or for the year ended December 31, 2000, 1999, and 1998 respectively.

(5) See "Senior Securities" on page 35 for more information regarding the Company's level of indebtedness.

(6) Excludes loans sold through securitization in January 1998. See "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Results of Operations -- Comparison of the Years Ended December 31, 2000, 1999 and 1998."

6

13

(IN THOUSANDS, EXCEPT PER SHARE DATA)	2001	2000				1	
	QTR 1	QTR 4	QTR 3	QTR 2	QTR 1	QTR 4	QTR 3
QUARTERLY DATA:							
Total interest and related portfolio income..........	$65,071	$61,735	$55,992	$49,965	$43,897	$42,278	$37,998
Net operating income before net realized and unrealized gains..........	39,728	34,725	30,719	24,700	22,573	21,319	19,273
Net increase in net assets resulting from operations................	52,028	42,281	36,449	34,790	29,581	30,925	26,944
Diluted net operating income per share..........	$ 0.46	$ 0.43	$ 0.40	$ 0.35	$ 0.34	$ 0.34	$ 0.31
Basic earnings per common share..............	0.61	0.52	0.48	0.50	0.45	0.49	0.44
Diluted earnings per common share..............	0.60	0.52	0.48	0.50	0.45	0.49	0.44
Net asset value per common share(1)...........	12.26	12.11	11.56	10.96	10.44	10.20	9.66
Dividends declared per common share..............	0.49	0.46	0.46	0.45	0.45	0.40	0.40

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

WHERE YOU CAN FIND ADDITIONAL INFORMATION

We have filed with the Commission a registration statement on Form N-2 together with all amendments and related exhibits under the Securities Act of 1933, as amended (the "Securities Act"). The registration statement contains additional information about us and the registered securities being offered by this prospectus. You may inspect the registration statement and the exhibits

without charge at the Securities and Exchange Commission at 450 Fifth Street, NW, Washington, DC 20549. You may obtain copies from the Commission at prescribed rates.

We file annual, quarterly and special reports, proxy statements and other information with the Commission. You can inspect, without charge, at the public reference facilities of the Commission at 450 Fifth Street, NW, Washington, DC 20549. The Commission also maintains a web site at http://www.sec.gov that contains reports, proxy statements and other information regarding public companies, including our Company. You can also obtain copies of these materials from the public reference section of the Commission at 450 Fifth Street, NW, Washington, DC 20549, at prescribed rates. Please call the Commission at 1-800-SEC-0330 for further information on the public reference room. Copies may also be obtained, after paying a duplicating fee, by electronic request to publicinfo@sec.gov or by written request to Public Reference Section, Washington, DC 20549-0102. You can also inspect reports and other information we file at the offices of the Nasdaq Stock Market, 1735 K Street, NW, Washington, DC 20006. After June 6, 2001, we will file the required reports and other information at the New York Stock Exchange and you will be able to inspect those at 20 Broad Street, New York, NY 10005.

RISK FACTORS

Investing in the Company involves a number of significant risks and other factors relating to the structure and investment objective of the Company. As a result, there can be no assurance that the Company will achieve its investment objective. In addition to the information contained in this prospectus, you should consider carefully the following information before making investments in the Securities.

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

OUR FINANCIAL RESULTS COULD BE NEGATIVELY AFFECTED IF BLX FAILS TO PERFORM AS EXPECTED. Business Loan Express, Inc. ("BLX") is our largest portfolio investment. Our financial results could be negatively affected if BLX, as a portfolio company, fails to perform as expected. At March 31, 2001, the investment totaled $211.1 million, or 10.7% of total assets. In addition, as controlling shareholder of BLX, the Company has provided an unconditional guaranty to BLX's credit facility lenders in an amount equal to 50% of BLX's total obligations on its $117.5 million unsecured revolving credit facility. The amount guaranteed by the Company at March 31, 2001 was $37.7 million. This guaranty can only be called in the event of a default by BLX.

OUR BORROWERS MAY DEFAULT ON THEIR PAYMENTS. We make unsecured, subordinated loans and invest in equity securities, which may involve a higher degree of repayment risk. We primarily invest in and lend to companies that may have limited financial resources and that may be unable to obtain financing from traditional sources. Numerous factors may affect a borrower's ability to repay its loan, including the failure to meet its business plan, a downturn in its

industry or negative economic conditions. Deterioration in a borrower's financial condition and prospects may be accompanied by deterioration in any collateral for the loan.

OUR PORTFOLIO OF INVESTMENTS IS ILLIQUID. We acquire most of our investments directly from private companies. The majority of the investments in our portfolio will be subject to restrictions on resale or otherwise have no established trading market. The illiquidity of most of our portfolio may adversely affect our ability to dispose of loans and securities at times when it may be advantageous for us to liquidate such investments.

INVESTMENTS IN NON-INVESTMENT GRADE COMMERCIAL MORTGAGE-BACKED SECURITIES MAY BE ILLIQUID AND MAY HAVE A HIGHER RISK OF DEFAULT. The commercial mortgage-backed securities ("CMBS") in which we invest are non-investment grade, which means that nationally recognized statistical rating organizations rate them below the top four investment-grade rating categories (i.e., "AAA" through "BBB"), and are sometimes referred to as "junk bonds." The non-investment grade CMBS tend to be less liquid, may have a higher risk of default and may be more difficult to value. Non-investment grade securities usually provide a higher yield than do investment-grade bonds, but with the

8

15

higher return comes greater risk. Non-investment grade securities are considered speculative, and their capacity to pay principal and interest in accordance with the terms of their issue is not ensured.

OUR PORTFOLIO INVESTMENTS ARE RECORDED AT FAIR VALUE AS DETERMINED BY THE BOARD OF DIRECTORS IN ABSENCE OF READILY ASCERTAINABLE PUBLIC MARKET VALUES. Pursuant to the requirements of the Investment Company Act of 1940 ("1940 Act"), the Board of Directors is required to value each asset quarterly, and we are required to carry our portfolio at fair value as determined by the Board of Directors. Since there is typically no public market for the loans and equity securities of the companies in which we make investments, our Board of Directors estimates the fair value of these loans and equity securities pursuant to a written valuation policy and a consistently applied valuation process. Unlike banks, we are not permitted to provide a general reserve for anticipated loan losses; we are instead required by the 1940 Act to specifically value each individual investment and record an unrealized loss for an asset that we believe has become impaired. Without a readily ascertainable market value, the estimated value of our portfolio of loans and equity securities may differ significantly from the values that would be placed on the portfolio if there existed a ready market for the loans and equity securities. We adjust quarterly the valuation of our portfolio to reflect the Board of Directors' estimate of the current realizable value of each investment in our portfolio. Any changes in estimated value are recorded in the Company's statement of operations as "Net unrealized gains (losses)."

WE BORROW MONEY WHICH MAGNIFIES THE POTENTIAL FOR GAIN OR LOSS ON AMOUNTS INVESTED AND MAY INCREASE THE RISK OF INVESTING IN OUR COMPANY. We borrow from, and issue senior debt securities to, banks, insurance companies and other lenders. Lenders of these senior securities have fixed dollar claims on our consolidated assets that are superior to the claims of our common shareholders. 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. If the value of our consolidated assets increases, then leveraging would cause the net asset value attributable to the Company's common stock to increase more sharply than it would have had we not leveraged. Conversely, if the value of our consolidated assets decreases, leveraging would cause net asset value to decline more sharply than it otherwise would have had we not leveraged. Similarly, any increase in our consolidated income in excess

of consolidated interest payable on the borrowed funds would cause our net income to increase more than it would without the leverage, while any decrease in our consolidated income would cause net income to decline more sharply than it would have had we not borrowed. Such a decline could negatively affect our ability to make common stock dividend payments. Leverage is generally considered a speculative investment technique.

At March 31, 2001, the Company had $883.8 million of outstanding indebtedness, bearing a weighted annual interest cost of 7.8%. In order for us to cover these annual interest payments on indebtedness, we must achieve annual returns on our portfolio of at least 3.5%.

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.

ASSUMED RETURN ON THE COMPANY'S PORTFOLIO
(NET OF EXPENSES)

	-20%	-10%	-5%	0%	5%	10%	20%
Corresponding return to shareholder(1).............	-44.0%	-25.3%	-15.9%	-6.6%	2.8%	12.2%	30.9%

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(1) The calculation assumes (i) $1,973.5 million in total assets, (ii) an average cost of funds of 7.8%, (iii) $883.8 million in debt outstanding and (iv) $1,054.2 million of shareholders' equity.

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 a class of senior security representing indebtedness of at least 200%. Our ability to achieve our investment objective may depend in part on our continued ability to maintain a leveraged capital structure by borrowing from banks or other lenders on favorable terms. There can be no assurance that we will be able to maintain such leverage. If asset coverage declines to less than 200%, we may be required to sell a portion of our investments when it is disadvantageous to do so. As of March 31, 2001, our asset coverage for indebtedness was 232%.

CHANGES IN INTEREST RATES MAY AFFECT OUR COST OF CAPITAL AND NET OPERATING INCOME. Because we borrow money to make investments, our net operating 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 portfolio income. In periods of sharply rising interest rates, our cost of funds would increase, which would reduce our net operating income before net realized and unrealized gains. However, there would be no effect on the return, if any, that could be generated from our equity interests. We use a combination of long-term and short-term borrowings and equity capital to finance our investing activities. The Company utilizes its short-term credit facilities only 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.

BECAUSE WE MUST DISTRIBUTE INCOME, WE WILL CONTINUE TO NEED ADDITIONAL CAPITAL TO GROW. We will continue to need capital to fund incremental growth in our investments. Historically, we have borrowed from financial institutions and have issued equity securities. A reduction in the availability of new capital could limit our ability to grow. We must distribute at least 90% of our taxable net operating income excluding net realized long-term capital gains to our stockholders to maintain our regulated investment company ("RIC") status. As a result such earnings will not be available to fund investment originations. We expect to continue to borrow from financial institutions and sell additional equity securities. If we fail to obtain funds from such sources or from other sources to fund our investments, it could limit our ability to grow, which could have a material adverse

effect on the value of the Company's common stock. In addition, as a business development company ("BDC"), 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.

OUR PRIVATE FINANCE INVESTMENTS MAY NOT PRODUCE CAPITAL GAINS. Private finance investments are typically structured as debt securities with a relatively high fixed rate of interest and with an equity feature such as conversion rights, warrants or options. As a result, private finance investments 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.

LOSS OF PASS-THROUGH TAX TREATMENT WOULD SUBSTANTIALLY REDUCE NET ASSETS AND INCOME AVAILABLE FOR DIVIDENDS. We have operated the Company so as to qualify to be taxed as a RIC under Subchapter M of the Internal Revenue Code of 1986, as amended ("Code"). If we meet source of income, diversification and distribution requirements, the Company qualifies for pass-through tax treatment. If the Company fails to qualify as a RIC, the Company would become subject to federal income tax as if it were an ordinary corporation, which would substantially reduce our net assets and the amount of income available for distribution to our shareholders. The Company would cease to qualify for pass-through tax treatment if it were unable to comply with these requirements, or if it ceased to qualify as a BDC under the 1940 Act. We also could be subject to a 4% excise tax and/or corporate level income tax if we fail to make required distributions.

WE OPERATE IN A COMPETITIVE MARKET FOR INVESTMENT OPPORTUNITIES. We compete for investments with many other companies and individuals, some of whom 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.

CHANGES IN THE LAW OR REGULATIONS THAT GOVERN THE COMPANY COULD HAVE A MATERIAL IMPACT ON THE COMPANY OR OUR OPERATIONS. We are regulated by the Securities and Exchange Commission and the SBA. In addition, changes in the laws or regulations that govern BDCs, RICs, real estate investment trusts ("REITs") and SBICs may significantly affect our business. Any change in the law or regulations that govern our business could have a material impact on the Company

or its 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.

QUARTERLY RESULTS MAY FLUCTUATE AND MAY NOT BE INDICATIVE OF FUTURE QUARTERLY PERFORMANCE. The Company's quarterly operating results could fluctuate and therefore, you should not rely on quarterly results to be indicative of the Company's performance in future quarters. Factors that could cause quarterly operating results to fluctuate include, among others, variations in the investment origination volume, variation in timing of prepayments, variations in and the timing of the recognition of realized and unrealized gains or losses, the degree to which we encounter competition in our markets and general economic conditions.

DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS

INFORMATION CONTAINED OR INCORPORATED BY REFERENCE IN THIS PROSPECTUS, AND THE ACCOMPANYING PROSPECTUS SUPPLEMENT, IF ANY, MAY CONTAIN "FORWARD-LOOKING STATEMENTS" WHICH CAN BE IDENTIFIED BY THE USE OF FORWARD-LOOKING TERMINOLOGY SUCH AS "MAY," "WILL," "EXPECT," "INTEND," "ANTICIPATE," "ESTIMATE" OR "CONTINUE" OR THE NEGATIVE THEREOF OR OTHER VARIATIONS OR SIMILAR WORDS OR PHRASES. THE MATTERS DESCRIBED IN "RISK FACTORS" AND CERTAIN OTHER FACTORS NOTED THROUGHOUT THIS PROSPECTUS, AND THE ACCOMPANYING PROSPECTUS SUPPLEMENT, IF ANY, AND IN ANY EXHIBITS TO THE REGISTRATION STATEMENT OF WHICH THIS PROSPECTUS, AND THE ACCOMPANYING PROSPECTUS SUPPLEMENT, IF ANY, 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.

THE COMPANY

Our Company is principally engaged in lending to and investing in private and undervalued public companies. The Company is organized in the state of Maryland and is an internally managed closed-end management investment company that has elected to be regulated as a business development company (as defined above, a "BDC") under the 1940 Act.

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

USE OF PROCEEDS

Unless otherwise specified in the prospectus supplement accompanying this prospectus, we intend to use the net proceeds from selling Securities for general corporate purposes, which may include investment in private and undervalued public companies, purchase of commercial mortgage-backed securities, repayment of indebtedness, acquisitions and other general corporate purposes.

We raise equity from time to time using a shelf registration statement. We raise new equity when we have a clear use of proceeds for attractive investment opportunities. Historically, this process has enabled us to raise equity on an accretive basis for existing shareholders of our common stock.

We anticipate that substantially all of the net proceeds of any offering of Securities will be used, as described above, within six months, but in no event longer than two years. Pending investment, we intend to invest the net proceeds of any offering of 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, and high quality debt securities maturing in one year or less from the time of investment. Our ability to achieve our investment objective may be limited to the extent that the net proceeds of any offering, pending full investment, are held in time deposits and other short-term instruments.

PRICE RANGE OF COMMON STOCK AND DISTRIBUTIONS

Our common stock is traded on the Nasdaq National Market under the symbol "ALLC." Beginning on June 6, 2001, the Company will trade on the New York Stock Exchange under the symbol "ALD." The following table lists the high and low closing sales prices for the Company's common stock. The stock quotations are interdealer quotations and do not include markups, markdowns or commissions. On May 23, 2001, the last reported closing sale price of the common stock was $24.62 per share.

	CLOSING SALE PRICE	
	HIGH	LOW
YEAR ENDED DECEMBER 31, 1999		
First Quarter	$20.250	$16.500
Second Quarter	24.000	17.000
Third Quarter	23.813	20.250
Fourth Quarter	23.125	16.750
YEAR ENDED DECEMBER 31, 2000		
First Quarter	$19.688	$16.063
Second Quarter	18.688	16.563
Third Quarter	21.125	17.438
Fourth Quarter	21.375	18.500
YEAR ENDING DECEMBER 31, 2001		
First Quarter	$24.436	$20.125
Second Quarter (through May 23, 2001)	24.930	19.570

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

We pay quarterly dividends to stockholders of our common stock. The amount of our quarterly dividends is determined by the Board of Directors. The Company's board has established a dividend policy to review the dividend rate quarterly and to adjust the quarterly dividend rate as the Company's earnings momentum builds. See "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Equity Capital and Dividends" and "Tax Status." We cannot assure that we will achieve investment results or maintain a tax status that will permit any particular level of dividend payment.

Our credit facilities limit our ability to declare dividends if we default under certain provisions.

We have adopted an "opt out" dividend reinvestment plan ("DRIP plan") for

our common stockholders. Under the DRIP plan, if your shares of our common stock are registered in your name, your dividends will be automatically reinvested in additional shares of common stock unless you "opt out" of the DRIP 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 the Selected Consolidated Financial Data and the Company's Consolidated Financial Statements and Notes thereto.

OVERVIEW

The Company provides private investment capital to private and undervalued public companies in a variety of different industries and in diverse geographic locations. Our lending and investment activity is focused in private finance and commercial real estate finance, primarily the purchase of commercial mortgage-backed securities.

The Company's portfolio composition at March 31, 2001, and December 31, 2000, 1999 and 1998 was as follows:

	AT MARCH 31,	AT DECEMBER 31,		
	2001	2000	1999	1998
Private Finance	69%	72%	53%	48%
Commercial Real Estate Finance	31%	28%	42%	44%
Small Business Finance	--%	--%	5%	8%

The Company's earnings depend primarily on the level of interest and related portfolio income and net realized and unrealized gains earned on the Company's investment portfolio after deducting interest paid on borrowed capital and operating expenses. Interest income results from the stated interest rate earned on a loan and the amortization of loan origination points and discounts. The level of interest income is directly related to the balance of the interest-bearing investment portfolio multiplied by the weighted average yield on the interest-bearing portfolio. The Company's ability to generate interest income is dependent on economic, regulatory and competitive factors that influence interest rates and loan originations, and the Company's ability to secure financing for its investment activities.

PORTFOLIO AND INVESTMENT ACTIVITY

Total portfolio investment activity and yields as of and for the three months ended March 31, 2001 and as of and for the years ended December 31, 2000, 1999 and 1998 were as follows:

($ IN MILLIONS)	MARCH 31, 2001	AT AND FOR THE YEARS ENDED DECEMBER 31, 2000	1999	1998

Portfolio at Value	$1,886.8	$1,788.0	$1,228.5	$807.1
New Investments	$ 150.8	$ 901.5	$ 751.9	$524.5
Repayments	$ 26.6	$ 154.1	$ 145.7	$138.0
Sales	$ 35.2	$ 280.2	$ 198.4	$304.4
Yield	14.3%	14.1%	13.0%	12.5%

PRIVATE FINANCE

Private finance investment activity and yields as of and for the three months ended March 31, 2001 and as of and for the years ended December 31, 2000, 1999 and 1998 were as follows:

($ IN MILLIONS)	AT AND FOR THE THREE MONTHS ENDED MARCH 31, 2001	AT AND FOR THE YEARS ENDED DECEMBER 31, 2000	1999	1998
Portfolio at Value	$1,303.3	$1,282.5	$647.0	$388.6
New Investments	$ 20.6	$ 600.9	$346.7	$236.0
Repayments	$ 17.1	$ 117.7	$ 87.5	$ 41.3
Yield	14.7%	14.6%	14.2%	14.6%

The private finance portfolio increased 2% from December 31, 2000 to March 31, 2001, and increased 98% and 67% during the years ended December 31, 2000 and 1999, respectively. Buyout and private finance activity across the industry slowed during the first quarter of 2001 largely due to credit tightening among senior lenders. Equity-focused buyout firms generally need both senior and subordinated debt to leverage private equity investments, and during the first quarter of 2001, the senior bank market, and in particular the senior syndicated loan market, was effectively closed. As a result, the Company completed the financing for only one buyout transaction during the quarter, with the Company investing $10.0 million. The Company also funded existing financing commitments for existing portfolio companies.

The Company's increasing capital base has enabled it to make larger private finance investments, supporting the increase in originations in 2000, 1999 and 1998. Key investment characteristics for new private finance mezzanine investments were as follows:

	FOR THE YEARS ENDED DECEMBER 31, 2000	1999	1998
New investment characteristics:			
Number of investments	34	27	19
Average investment size (millions)	$ 14.0	$12.4	$10.6
Average current yield	14.7%	13.6%	13.3%

Average portfolio company revenue (millions)......	$153.5	$86.9	$81.3
Average portfolio company years in business.......	36	29	22

The average investment characteristics above are computed using simple averages based upon underwriting data for investment activity for that year. As a result, any one investment may have had individual investment characteristics that may vary significantly from the stated simple average. In addition, average investment characteristics may vary from year to year.

The current yield on the private finance portfolio will fluctuate over time depending on the equity "kicker" or warrants received with each debt financing. Private finance investments are generally structured such that equity kickers may provide an additional future investment return of up to 10%.

16

23

In addition to the Company's core private finance investment activity during 2000, the Company acquired 95% of BLC Financial Services, Inc. in a "going private" buyout transaction for $95.2 million on December 31, 2000. The Company issued approximately 4.1 million shares, or $86.1 million of new equity, and paid $9.1 million in cash to acquire BLC. The new portfolio company has changed its name to Business Loan Express, Inc. ("BLX").

As part of the transaction, the Company recapitalized its Allied Capital Express operations as an independently managed private portfolio company and merged it into BLX. As part of the recapitalization, the Company contributed certain assets, including the online rules-based underwriting technology and fixed assets, and transferred 37 employees into the private portfolio company. Upon completion of the transaction, the Company's investment in BLX totaled $204.1 million and consisted of $74.5 million of 25% subordinated debt, $25.1 million of preferred stock, and $104.5 million of common stock on December 31, 2000.

At March 31, 2001, the Company's investment in BLX totaled $211.1 million at value and consisted of $66.0 million of 25% subordinated debt, $25.1 million of preferred stock and $120.0 million of common stock. During the first quarter of 2001, BLX secured a 3-year $117.5 million revolving credit facility ("BLX Credit Facility") and completed a $65 million securitization of unguaranteed SBA 7(a) loans. As a result of the elimination of the refinancing risk that existed at the time of the merger, and BLX's progress in merger integration, the Company increased the value of its common stock investment by $15.5 million to $120.0 million at March 31, 2001. As the controlling shareholder of BLX, the Company has provided an unconditional guaranty to the BLX Credit Facility lenders in an amount of up to 50% of the total obligations (consisting of principal, accrued interest and other fees) of BLX on the line of credit. The amount guaranteed by the Company at March 31, 2001 was $37.7 million. This guaranty can be called by the lenders only in the event of a default by BLX. BLX was in compliance with the terms of the BLX Credit Facility at March 31, 2001. In consideration for providing this guaranty, BLX will pay the Company an annual guaranty fee of $2.9 million. In addition, the Company has entered into a management contract with BLX to provide management services, including certain technology and transition services. The Company's investment in BLX is included in the private finance portfolio.

BLX is a non-bank small business lender licensed as a participant in the SBA 7(a) Guaranteed Loan Program. BLX is headquartered in New York City, has 28 offices throughout the country and is an SBA-designated Preferred Lender in 64 markets.

During the second quarter of 2000, the Company began an initiative to

invest in and strategically partner with select private equity funds focused on venture capital investments. The strategy for these fund investments is to provide solid investment returns and build strategic relationships with the fund managers and their portfolio companies. The Company believes that it will have opportunities to co-invest with the funds as well as finance their portfolio companies as they mature.

The Company believes that the fund investment strategy is an effective means of participating in private equity investing through a diverse pooled investment portfolio. The fund concept allows the Company to participate in a pooled investment return without exposure to the risk of any single investment. Since the beginning of 2000, the Company has committed a total of $44.5 million to eight private equity funds. The committed amount is expected to be invested over the next three years. The Company funded

$1.6 million and $7.0 million of this commitment for the three months ended March 31, 2001 and for the year ended December 31, 2000, respectively.

COMMERCIAL REAL ESTATE FINANCE

Commercial real estate finance investment activity and yields as of and for the three months ended March 31, 2001 and as of and for the years ended December 31, 2000, 1999 and 1998 were as follows:

($ IN MILLIONS)	AS OF AND FOR THE THREE MONTHS ENDED MARCH 31, 2001	AS OF AND FOR THE YEARS ENDED DECEMBER 31,		
		2000	1999	1998
Portfolio at Value...........	$583.5	$505.5	$520.0	$355.0
New Investments..............	$130.2	$149.0	$288.7	$214.6
Repayments...................	$ 9.4	$ 24.8	$ 51.5	$ 92.5
Sales........................	$ 35.2	$151.7	$ 86.1	$256.9
Yield........................	13.7%	13.1%	12.3%	10.4%

The commercial real estate finance portfolio increased 15% from December 31, 2000 to March 31, 2001, and decreased 3% and increased 46% for the years ended December 31, 2000 and 1999, respectively. During 1998, the Company reduced its commercial mortgage loan origination activity for its own portfolio due to declining interest rates and began to sell its loans to other lenders. Then, beginning in the fourth quarter of 1998, the Company began to take advantage of a unique market opportunity to acquire non-investment grade commercial mortgage-backed securities ("CMBS") at significant discounts from the face amount of the bonds. Turmoil in the capital markets at that time created a lack of liquidity for the traditional buyers of non-investment grade bonds. As a result, yields on these collateralized bonds increased, thus providing an attractive investment opportunity. The Company believes that CMBS is an attractive asset class because of the yields that can be earned on a security that is fully secured by commercial mortgage loans. The Company has opportunistically purchased CMBS since the fourth quarter of 1998. The Company plans to continue its CMBS investment activity, however, in order to maintain a balanced portfolio the Company expects that purchased CMBS will continue to represent approximately 20% to 25% of total assets during 2001. The Company's CMBS investment activity level will be dependent upon its ability to purchase

CMBS at attractive yields.

The Company purchases CMBS at an average discount of 50% from the face amount of the bonds. During the first quarter of 2001, the Company purchased $104.4 million in CMBS with a face value of $182.3 million. In addition, the Company purchased $24.6 million in non-investment grade securities related to a collateralized debt obligation secured by CMBS and investment grade REIT bonds. The weighted average yield to maturity on first quarter 2001 purchases is 15.9% after assuming a 1% loss rate on the underlying collateral mortgage pool. During 2000, the Company purchased $124.3 million in CMBS with a face amount of $244.6 million and a weighted average yield to maturity of 14.7% after assuming a 1% loss rate on the underlying collateral mortgage pool. In 1999, the Company purchased $245.9 million in CMBS with a face amount of $507.9 million and a weighted average yield to maturity of 14.6% after assuming a 1% loss rate on the underlying collateral mortgage pool.

18

25

As part of the Company's strategy to maximize its return on equity capital, during the first quarter of 2001 the Company sold $35.2 million and during the fourth quarter of 2000 the Company sold $98.7 million of CMBS bonds rated BB+, BB and BB-. These bonds had an effective yield of 10.5% and 11.5%, and were sold for $36.1 million and $102.5 million, respectively, resulting in a realized gain on the sale. The sale of these lower-yielding bonds increased the Company's overall liquidity. The effective yield on the Company's remaining purchased CMBS portfolio at March 31, 2001 was 15.6%, after assuming a 1% loss on the entire underlying mortgage loan pool. At March 31, 2001 and December 31, 2000, the value of the purchased CMBS portfolio was $406.6 million and $311.3 million and the unamortized discount was $431.7 million and $364.9 million, respectively.

The original principal balance of the underlying pool of the approximately 2,900 loans that are collateral for the Company's CMBS had underwritten loan to value ("LTV") and underwritten debt service coverage ratios ("DSCR") as follows:

LOAN TO VALUE RANGES	$ ($ IN MILLIONS)	%
Less than 60%	$ 1,693.3	12%
60-65%	1,219.6	8%
65-70%	2,425.1	17%
70-75%	4,824.1	33%
75-80%	4,304.5	29%
Greater than 80%	190.7	1%
	$14,657.3	100%
Weighted average LTV	69.6%	

DEBT SERVICE COVERAGE RATIO RANGES	$ ($ IN MILLIONS)	%

Greater than 2.00	$ 467.6	3%
1.76-2.00	446.5	3%
1.51-1.75	1,694.7	12%
1.26-1.50	8,333.2	57%
1.00-1.25	3,715.3	25%
	$14,657.3	100%
Weighted average DSCR	1.41	

The Company has been liquidating much of its whole commercial mortgage loan portfolio so that it can redeploy the proceeds into higher yielding assets. There were no commercial mortgage loan sales for the three months ended March 31, 2001. For the years ended December 31, 2000 and 1999, the Company sold $53.1 million and $86.1 million of commercial mortgage loans, respectively. At March 31, 2001, the Company's whole commercial real estate loan portfolio had been reduced to $99.5 million from $106.4 million at December 31, 2000.

During 1998, the Company sold through securitization approximately $295 million in lower yielding commercial mortgage loans and sold whole loans to third parties aggregating approximately $33.5 million.

SMALL BUSINESS FINANCE

As discussed above in the Private Finance section, the Company established its Allied Capital Express operations as an independently managed private portfolio company at the end of 2000. These operations are now included in the private finance portfolio.

During the second quarter of 1999, the Company combined its whole commercial real estate loan origination activity with its SBA 7(a) lending activity in order to increase its loans originated for sale business under the Allied Capital Express brand name. Through Allied Capital Express, the Company provided small business and commercial real estate loans up to $3 million. The majority of the loans originated in this area were originated for sale, generally at premiums of up to 10% of the loan amount.

Allied Capital Express loan activity and yields as of and for the years ended December 31, 2000, 1999 and 1998 were as follows:

($ IN MILLIONS)	2000	1999	1998
Portfolio at Value	$ --	$ 61.4	$63.6
New Investments	$151.6	$116.5	$73.9
Repayments	$ 11.6	$ 6.7	$ 4.2
Sales	$128.5	$112.3	$47.5
Yield	--	11.5%	11.2%

Allied Capital Express loan origination activity for 2000 and 1999 increased due to the opening of new regional office locations and from opportunities created by the Company's Internet site launched in the fall of 1999. Loans in the Allied Capital Express program were originated for sale; therefore, the increase in loan sales was the result of the increase in originations. In addition, beginning in 1999, the Company began to sell 90% of

the unguaranteed portion of SBA 7(a) loans through a structured finance agreement with a commercial paper conduit. Allied Capital Express targeted small commercial real estate loans that were, in many cases, originated in conjunction with SBA 7(a) loans. SBA 7(a) loans were originated with variable interest rates priced at spreads ranging from 1.75% to 2.75% over the prime lending rate.

RESULTS OF OPERATIONS

COMPARISON OF THREE MONTHS ENDED MARCH 31, 2001 AND 2000

The following table summarizes Allied Capital's operating results for the three months ended March 31, 2001 and 2000.

($ IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)	FOR THE THREE MONTHS ENDED MARCH 31, 2001	2000	CHANGE	PERCENT CHANGE
INTEREST AND RELATED PORTFOLIO INCOME				
Interest and dividends	$54,875	$38,812	$ 16,063	41%
Premiums from loan dispositions	821	3,289	(2,468)	(75)%
Investment advisory fees and other income	9,375	1,796	7,579	422%
Total interest and related portfolio income	65,071	43,897	21,174	48%
EXPENSES				
Interest	15,930	12,311	3,619	29%
Employee	6,418	4,569	1,849	40%
Administrative	2,967	2,753	214	8%
Total operating expenses	25,315	19,633	5,682	29%
Formula and cut-off awards	28	1,691	(1,663)	(98)%
Net operating income before net realized and unrealized gains	39,728	22,573	17,155	76%
NET REALIZED AND UNREALIZED GAINS				
Net realized gains	1,154	2,176	(1,022)	(47)%
Net unrealized gains	11,146	4,832	6,314	131%
Total net realized and unrealized gains	12,300	7,008	5,292	76%
Net increase in net assets resulting from operations	$52,028	$29,581	$ 22,447	76%
Diluted net operating income per share	$ 0.46	$ 0.34	$ 0.12	35%
Diluted earnings per share	$ 0.60	$ 0.45	$ 0.15	33%
Weighted average shares				

outstanding -- diluted..................	87,059	66,308	20,751	31%

Net increase in net assets resulting from operations (NIA) results from total interest and related portfolio income earned, less total expenses incurred in the operations of the Company, plus net realized and unrealized gains or losses.

Total interest and related portfolio income is primarily a function of the level of interest income earned and the balance of portfolio assets. In addition, total interest and

related portfolio income includes dividend income, premiums from loan dispositions, prepayment premiums, and investment advisory fees and other income.

	FOR THE THREE MONTHS ENDED MARCH 31,	
($ IN MILLIONS, EXCEPT PER SHARE AMOUNTS)	2001	2000
Total Interest and Related Portfolio Income..............	$65.1	$43.9
Per share...	$0.75	$0.66

The increase in interest income earned results primarily from continued growth of the Company's investment portfolio and the Company's focus on increasing its overall portfolio yield. The Company's investment portfolio, excluding non-interest bearing equity interests in portfolio companies, increased by 22% to $1,542.9 million at March 31, 2001 from $1,260.1 million at March 31, 2000. The weighted average yield on the interest bearing investments in the portfolio at March 31, 2001 and 2000 was as follows:

	MARCH 31,	
	2001	2000
Private Finance...	14.7%	13.9%
Commercial Real Estate Finance..........................	13.7%	12.5%
Small Business Finance..................................	--%	11.3%
Total Portfolio...	14.3%	13.0%

Included in net premiums from loan dispositions are premiums from loan sales and premiums received on the early repayment of loans. There were no premiums from loan sales for the three months ended March 31, 2001. For the three months ended March 31, 2000, premiums from loan sales were $2.2 million, resulting primarily from the premium paid by purchasers of loans originated through Allied Capital Express, less the origination commissions associated with the loans sold. Upon the merger of the Allied Capital Express operations into BLX, the premium from loan sales earned historically is intended to be replaced with interest income earned by the Company from its subordinated debt investment

in BLX as well as fees earned from its guaranty of the BLX Credit Facility and its management contract with BLX.

Prepayment premiums were $0.8 million and $1.1 million for the three months ended March 31, 2001 and 2000, respectively. While the scheduled maturities of private finance and commercial real estate loans range from five to ten years, it is not unusual for the Company's borrowers to refinance or pay off their debts to the Company ahead of schedule. Because the Company seeks to finance primarily seasoned, performing companies, such companies at times can secure lower cost financing as their balance sheets strengthen, or as more favorable interest rates become available. Therefore, the Company generally structures its loans to require a prepayment premium for the first three to five years of the loan.

Investment advisory fees and other income include diligence and structuring fees from our investing activities of $4.8 million and management and guaranty fees from BLX of $3.7 million for the three months ended March 31, 2001. Diligence and structuring fees are separately negotiated on each portfolio investment, and therefore, may vary from quarter to quarter.

22

29

Operating expenses include interest, employee and administrative expenses. The Company's single largest expense is interest on indebtedness. The fluctuations in interest expense during the three months ended March 31, 2001 and 2000 are attributable to changes in the level of borrowings by the Company and its subsidiaries under various notes payable and debentures and revolving credit facilities. The Company's borrowing activity and weighted average interest cost, including fees and closing costs, were as follows:

($ IN MILLIONS)	AT AND FOR THE THREE MONTHS ENDED MARCH 31, 2001	2000
Total Outstanding Debt	$883.8	$683.4
Average Outstanding Debt	$790.1	$627.3
Weighted Average Cost	7.8%	7.9%
BDC Asset Coverage*	232%	217%

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*As a BDC, the Company is generally required to maintain a ratio of 200% of total assets to total borrowings.

Employee expenses include salaries and employee benefits. The increase in salaries and employee benefits for the periods presented reflects wage increases and the experience level of employees hired. Total employees were 96 and 125 at March 31, 2001 and 2000, respectively. As part of the recapitalization of Allied Capital Express discussed above, employees of the Company were transferred to the portfolio company at the end of 2000. Expenses related to 30 employees dedicated to Allied Capital Express are reflected in employee expense and the number of employees for the three months ended March 31, 2000.

Administrative expenses include the leases for the Company's headquarters in Washington, DC, and its regional offices, travel costs, stock record

expenses, directors' fees, legal and accounting fees and various other expenses. For the three months ended March 31, 2001 and 2000, employee and administrative costs as a percentage of total interest and related portfolio income less interest expense plus net realized and unrealized gains was 15% and 19%, respectively.

The formula and cut-off awards totaled $1.7 million, or $0.03 per share, for the three months ended March 31, 2000. The formula award vested over a three-year period which ended on December 31, 2000.

Net realized gains resulted from the sale of equity securities associated with certain private finance investments and the realization of unamortized discount resulting from the sale and early repayment of private finance loans, commercial mortgage loans and

23

30

Purchased CMBS bonds, offset by losses on investments. Realized gains and losses were as follows:

($ IN MILLIONS)	FOR THE THREE MONTHS ENDED MARCH 31, 2001	2000
Realized Gains	$ 1.9	$ 2.7
Realized Losses	(0.7)	(0.5)
Net Realized Gains	$ 1.2	$ 2.2
Net Unrealized Gains	$11.1	$ 4.8

Realized gains for the three months ended March 31, 2001 primarily resulted from a transaction involving one portfolio company, Southwest PCS, LLC ($0.8 million). Realized gains for the three months ended March 31, 2000 resulted primarily from transactions involving two portfolio companies. The Company reversed previously recorded unrealized appreciation totaling $1.1 million and $2.1 million when these gains were realized for the three months ended March 31, 2001 and 2000, respectively.

Realized losses for the three months ended March 31, 2001 resulted from the liquidation of certain portfolio investments. Losses realized for the three months ended March 31, 2001 and 2000 had been recognized in NIA over time as unrealized depreciation when the Company determined that the respective portfolio security's value had become impaired. Thus, the Company reversed previously recorded unrealized depreciation totaling $0.7 million and $0.4 million when the related losses were realized for the three months ended March 31, 2001 and 2000, respectively.

Net unrealized gains for the three months ended March 31, 2001 and 2000 consisted of valuation changes resulting from the Board of Directors' valuation of the Company's assets and the effect of reversals of unrealized appreciation or depreciation resulting from realized gains or losses.

The Company increased the value of its equity investment in BLX by $15.5

million at March 31, 2001. During the first quarter, BLX secured a 3-year $117.5 million revolving credit facility and completed a $65 million securitization of unguaranteed SBA 7(a) loans. As a result of the elimination of the refinancing risk that existed at the time of the merger, and BLX's progress in merger integration, the Company increased the value of its equity investment. The Company also increased the value of its investment in Wyo-Tech Acquisition Corporation by $8.8 million, due to its continued growth and positive performance. In addition to BLX and Wyo-Tech, the Company increased the value of other portfolio companies by $6.1 million in total. These companies increased in value because of continued positive performance, and valuation data that would indicate that a valuation increase was necessary.

The Company decreased the value of its common equity investment in Startec Global Communications Corporation by $3.0 million. The Company also decreased the value of its debt investment in NETtel Communications, Inc. by $5.0 million. In addition, the Company decreased the value of other portfolio companies by a total of $11.3 million.

At March 31, 2001, net unrealized appreciation in the portfolio totaled $30.5 million and was composed of unrealized appreciation of $75.5 million, resulting primarily from

appreciated equity interests in portfolio companies, and unrealized depreciation of $45.0 million, resulting primarily from underperforming loan and equity interests in the portfolio. Net realized and unrealized gains can vary substantially on a quarterly basis.

The Company employs a standard grading system for the 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 interest or principal is expected. Grade 4 is used for investments for which some loss of contractually due interest is expected, but no loss of principal is expected. Grade 5 is used for investments for which some loss of principal is expected and the investment is written down to net realizable value.

At March 31, 2001, the Company's portfolio was graded as follows:

GRADE	PORTFOLIO AT VALUE (IN MILLIONS)	PERCENTAGE OF TOTAL PORTFOLIO
1	$ 430.3	22.8%
2	1,323.5	70.2%
3	35.3	1.9%
4	61.1	3.2%
5	36.6	1.9%
	$1,886.8	100.0%

Included in Grade 4 and 5 investments are assets totaling $14.4 million that are secured by commercial real estate at March 31, 2001. Grade 5 private finance investments at March 31, 2001, totaled $34.0 million, at value, or 1.8%, of the Company's total portfolio, respectively. Total Grade 4 and 5 assets as a

percentage of the total portfolio at value at March 31, 2001 and December 31, 2000 and 1999 were 5.1%, 5.7% and 3.8%, respectively. The Company expects that a certain number of portfolio companies will be in the Grade 4 or 5 category from time to time. Part of the business of private finance is working with troubled portfolio companies to improve their businesses and protect the Company's investment. The number of portfolio companies and related investment amount included in Grade 4 and 5 may fluctuate significantly from quarter to quarter as the Company helps these companies work through their problems. The Company continues to follow its historical practices of working with a troubled portfolio company in order to recover the maximum amount of the Company's investment, but records unrealized depreciation for the expected full amount of the potential loss when such exposure is identified.

At March 31, 2001, delinquencies in the underlying collateral pool for the Company's CMBS portfolio were 0.5%. The yield used to accrue interest on this portfolio assumes a 1% loss rate on the entire underlying collateral mortgage pool, and as of March 31, 2001, no losses have been realized.

For the total investment portfolio, loans greater than 120 days delinquent were $55.3 million at value at March 31, 2001, or 2.9% of the total portfolio. Included in this category are loans valued at $9.8 million that are fully secured by real estate. Loans greater than 120 days delinquent generally do not accrue interest. Loans greater than 120 days delinquent at December 31, 2000 were $56.4 million at value, or 3.2% of the total portfolio, which included $13.3 million that were fully secured by real estate. As a provider

of long-term privately negotiated investment capital, it is not atypical to defer payment of principal or interest from time to time. As a result, the amount of the portfolio that is greater than 120 days delinquent may vary from quarter to quarter. The terms of the private finance agreements frequently provide an opportunity for portfolio companies to restructure their debt and equity capital. During such restructuring, the Company may not receive or accrue interest or dividend payments. The investment portfolio is priced to provide current returns for our shareholders assuming that a portion of the portfolio at any time may not be accruing interest currently. The Company also prices its investments for a total return including current interest or dividends plus capital gains from the sale of equity securities. Therefore, the amount of loans greater than 120 days delinquent is not necessarily an indication of future principal loss or loss of anticipated investment return. The Company's portfolio grading system is used as a means to assess loss of investment return (Grade 4 assets) or loss of investment principal (Grade 5 assets).

The Company has elected to be taxed as a regulated investment company ("RIC") under Subchapter M of the Internal Revenue Code of 1986, as amended ("Code"). As long as the Company qualifies as a RIC, the Company is not taxed on its investment company taxable income or realized capital gains, to the extent that such income or gains are distributed, or deemed to be distributed, to shareholders on a timely basis. Annual tax distributions may differ from NIA for the fiscal year due to timing differences in the recognition of income and expenses, returns of capital and net unrealized appreciation or depreciation, which are not included in taxable income.

In order to maintain its RIC status, the Company must, in general, (1) derive at least 90% of its gross income from dividends, interest, gains from the sale of securities and other specified types of income; (2) meet investment diversification requirements as defined in the Code; and (3) distribute annually to shareholders at least 90% of its investment company taxable ordinary income. The Company intends to take all steps necessary to continue to meet the RIC qualifications. However, there can be no assurance that the Company will

continue to elect or qualify for such treatment in future years.

The weighted average common shares outstanding used to compute basic earnings per share were 85.5 million and 66.3 million for the three months ended March 31, 2001 and 2000, respectively. The increases in the weighted average shares reflect the issuance of new shares and the issuance of shares pursuant to a dividend reinvestment plan.

All per share amounts included in management's discussion and analysis have been computed using the weighted average shares used to compute diluted earnings per share, which were 87.1 million and 66.3 million for the three months ended March 31, 2001 and 2000, respectively.

26

33

RESULTS OF OPERATIONS

COMPARISON OF THE YEARS ENDED DECEMBER 31, 2000, 1999 AND 1998

The following table summarizes Allied Capital's operating results for the years ended December 31, 2000, 1999 and 1998:

	2000	1999	CHANGE	PERCENT CHANGE	1999	19
			(IN THOUSANDS, EXCEPT PER SHARE AMOUN			
INTEREST AND RELATED PORTFOLIO INCOME						
Interest and dividends............	$182,307	$121,112	$61,195	51%	$121,112	$80,
Premiums from loan dispositions....	16,138	14,284	1,854	13%	14,284	5,
Post-Merger gain on securitization of commercial mortgage loans.....	--	--	--	0%	--	14,
Investment advisory fees and other income.........................	13,144	5,744	7,400	129%	5,744	5,
Total interest and related portfolio income..........	211,589	141,140	70,449	50%	141,140	106,
EXPENSES						
Interest..........................	57,412	34,860	22,552	65%	34,860	20,
Employee..........................	19,842	16,136	3,706	23%	16,136	11,
Administrative....................	15,435	12,350	3,085	25%	12,350	11,
Total operating expenses.....	92,689	63,346	29,343	46%	63,346	44,
Formula and cut-off awards.........	6,183	6,753	(570)	(8%)	6,753	7,
Net operating income before net realized and unrealized gains.....................	112,717	71,041	41,676	59%	71,041	55,
NET REALIZED AND UNREALIZED GAINS						
Net realized gains................	15,523	25,391	(9,868)	(39%)	25,391	22,
Net unrealized gains..............	14,861	2,138	12,723	595%	2,138	1,
Total net realized and unrealized gains..........	30,384	27,529	2,855	10%	27,529	23,
Income before income taxes..........	143,101	98,570	44,531	45%	98,570	78,

Income tax expense..................	--	--	--	0%	--	----
Net increase in net assets resulting from operations...................	$143,101	$ 98,570	$44,531	45%	$ 98,570	$78,
Diluted net operating income per share.............................	$ 1.53	$ 1.18	$ 0.35	30%	$ 1.18	$ 1
Diluted earnings per share...........	$ 1.94	$ 1.64	$ 0.30	18%	$ 1.64	$ 1
Weighted average shares outstanding - diluted...........................	73,472	60,044	13,428	22%	60,044	51,

Net increase in net assets resulting from operations (NIA) results from total interest and related portfolio income earned, less total expenses incurred in the operations of the Company, plus net realized and unrealized gains or losses.

Total interest and related portfolio income is primarily a function of the level of interest income earned and the balance of portfolio assets. In addition, total interest and

related portfolio income includes premiums from loan dispositions, prepayment premiums, and investment advisory fees and other income.

	2000	1999	1998
	(IN MILLIONS, EXCEPT PER SHARE AMOUNTS)		
Total Interest and Related Portfolio Income....	$211.6	$141.1	$106.7
Per share....................................	$ 2.88	$ 2.35	$ 2.05

The increase in interest income earned results primarily from continued growth of the Company's investment portfolio and the Company's focus on increasing its overall portfolio yield. The Company's investment portfolio, excluding non-interest bearing equity interests in portfolio companies, increased by 29% to $1,471.8 million at December 31, 2000 from $1,141.2 million at December 31, 1999, and increased by 51% during 1999 from $757.7 million at December 31, 1998. The weighted average yield on the interest bearing investments in the portfolio at December 31, 2000, 1999 and 1998 was as follows:

	2000	1999	1998
Private Finance..................................	14.6%	14.2%	14.6%
Commercial Real Estate Finance.................	13.1%	12.3%	10.4%
Small Business Finance.........................	--	11.5%	11.2%
Total Portfolio..................................	14.1%	13.0%	12.5%

Included in net premiums from loan dispositions are premiums from loan sales and premiums received on the early repayment of loans. Premiums from loan

sales were $13.3 million, $10.5 million and $3.8 million for the years ended December 31, 2000, 1999 and 1998, respectively. This premium income results primarily from the premium paid by purchasers of loans originated through Allied Capital Express, less the origination commissions associated with the loans sold. In addition to selling the guaranteed portion of the SBA 7(a) loans, in 1999 the Company began to sell 90% of the unguaranteed portion of SBA 7(a) loans through a structured finance agreement with a commercial paper conduit. The 176% increase in premiums from loan sales in 1999 is primarily the result of a significant increase in the sale of the guaranteed SBA 7(a) loans and unguaranteed portions of SBA 7(a) loans. SBA 7(a) loan sales were $101.0 million, $93.7 million and $37.0 million for the years ended December 31, 2000, 1999 and 1998, respectively. Upon the merger of the Allied Capital Express operations into BLX, the premium from loan sales earned historically is intended to be replaced with interest income earned by the Company from its subordinated debt investment in BLX as well as fees earned from its management contract with BLX.

Prepayment premiums were $2.8 million, $3.8 million and $2.2 million for the years ended December 31, 2000, 1999 and 1998, respectively. While the scheduled maturities of private finance and commercial real estate loans range from five to ten years, it is not unusual for the Company's borrowers to refinance or pay off their debts to the Company ahead of schedule. Because the Company seeks to finance primarily seasoned, performing companies, such companies at times can secure lower cost financing as their balance sheets strengthen, or as more favorable interest rates become available. Therefore, the Company generally structures its loans to require a prepayment premium for the first three to five years of the loan.

Total interest and related portfolio income for 1998 includes a one-time gain on sale of $14.8 million resulting from a commercial mortgage loan securitization transaction that

was completed in January 1998. Excluding the 1998 gain on sale, total interest and related portfolio income increased for the year ended December 31, 1999 by 53% as compared to the year ended December 31, 1998. The proceeds of $238.4 million from this transaction were used to repay outstanding debt.

Operating expenses include interest, employee and administrative expenses. The Company's single largest expense is interest on indebtedness. The fluctuations in interest expense during 2000, 1999 and 1998 are attributable to changes in the level of borrowings by the Company and its subsidiaries under various notes payable and debentures and revolving credit facilities. The Company's borrowing activity and weighted average interest cost, including fees and closing costs, were as follows:

	2000	1999	1998
	($ IN MILLIONS)		
Total Outstanding Debt	$786.6	$592.9	$334.4
Average Outstanding Debt	$707.4	$461.5	$261.3
Weighted Average Cost	8.3%	7.9%	7.5%
BDC Asset Coverage*	245%	228%	273%

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* As a BDC, the Company is generally required to maintain a ratio of 200% of

total assets to total borrowings.

Employee expenses include salaries and employee benefits. The increase in salaries and employee benefits for the periods presented reflects the increase in total employees, combined with wage increases and the experience level of employees hired. Total employees were 97, 129 and 106 at December 31, 2000, 1999 and 1998, respectively. As part of the recapitalization of Allied Capital Express discussed above, 37 employees of the Company were transferred to the portfolio company at the end of 2000. Expenses related to these employees are reflected in employee expense for the year.

Administrative expenses include the leases for the Company's headquarters in Washington, DC and its regional offices, travel costs, stock record expenses, directors' fees, legal and accounting fees and various other expenses. For the years ended December 31, 2000, 1999 and 1998, employee and administrative costs as a percentage of total interest and related portfolio income less interest expense plus net realized and unrealized gains was 19%, 21% and 22%, respectively.

The formula and cut-off awards totaled $6.2 million, $6.8 million and $7.0 million, or $0.08 per share, $0.11 per share and $0.14 per share, for the years ended December 31, 2000, 1999 and 1998, respectively.

The formula award expense totaled $5.7 million, $6.2 million and $6.2 million for the years ended December 31, 2000, 1999 and 1998, respectively. The formula award was designed as an incentive compensation program that would replace canceled stock options that were canceled as a result of the Company's 1997 Merger and would balance share ownership among key officers. The formula award vested over a three-year period, on the anniversary date of the Merger, beginning on December 31, 1998.

The cut-off award expense totaled $0.5 million, $0.6 million and $0.8 million for the years ended December 31, 2000, 1999 and 1998, respectively. The cut-off award was designed to cap the appreciated value in unvested options at the Merger announcement date in order to set the foundation to balance option awards upon the Merger. The cut-off

award will only be payable if the award recipient is employed by the Company on a future vesting date.

Net realized gains resulted from the sale of equity securities associated with certain private finance investments and the realization of unamortized discount resulting from the sale and early repayment of private finance loans, commercial mortgage loans and Purchased CMBS bonds, offset by losses on investments. Realized gains and losses and net unrealized gains for the years ended December 31, 2000, 1999 and 1998 were as follows:

	2000	1999	1998
	(IN MILLIONS)		
Realized Gains	$28.6	$31.5	$25.8
Realized Losses	(13.1)	(6.1)	(3.3)
Net Realized Gains	$15.5	$25.4	$22.5
Net Unrealized Gains	$14.9	$ 2.1	$ 1.1

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Realized gains during 2000 resulted primarily from transactions involving eight investments -- Southwest PCS, L.P. ($11.5 million), Grant Television, Inc. ($5.4 million), CMBS bonds sold ($3.9 million), Julius Koch USA, Inc. ($1.7 million), Wilmar Industries, Inc. ($1.2 million), Hotelevision ($1.0 million), FTI Consulting, Inc. ($0.7 million) and Panera Bread Co. ($0.7 million). The Company reversed previously recorded unrealized appreciation of $7.5 million when these gains were realized in 2000. Realized gains in 1999 and 1998 resulted primarily from transactions involving 6 and 10 portfolio companies, and the Company reversed previously recorded unrealized appreciation of $14.6 million and $8.1 million, respectively, when these gains were realized.

Realized losses in 2000, 1999 and 1998 represented 0.7%, 0.5% and 0.4% of the Company's total assets, respectively. Realized losses of $13.1 million during 2000 resulted primarily from two portfolio investments -- NETtel Communications, Inc. ($8.5 million) and Total Foam, Inc. ($1.3 million). The remaining losses consisted of several losses of less than $0.5 million each. Losses realized in 2000 had been recognized in NIA over time as unrealized depreciation when the Company determined that the respective portfolio security's value had become impaired. Thus, the Company reversed previously recorded unrealized depreciation totaling $12.0 million, $5.4 million and $3.6 million when the related losses were realized in 2000, 1999 and 1998, respectively.

Net unrealized gains for 2000, 1999 and 1998 consisted of valuation changes resulting from the Board of Directors' valuation of the Company's assets and the effect of reversals of unrealized appreciation or depreciation resulting from realized gains or losses. At December 31, 2000, net unrealized appreciation in the portfolio totaled $19.4 million and was composed of unrealized appreciation of $49.1 million, resulting primarily from appreciated equity interests in portfolio investments, and unrealized depreciation of $29.7 million resulting primarily from underperforming loan and equity interests in the portfolio. At December 31, 1999 and 1998, net unrealized appreciation in the portfolio totaled $4.5 millio