

ALLIED CAPITAL CORP
Form 10-K
February 26, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

- x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For The Fiscal Year Ended December 31, 2009

OR

- o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

Commission File No. 0-22832

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

Maryland
(State or Other Jurisdiction of
Incorporation)

52-1081052
(I.R.S. Employer
Identification No.)

1919 Pennsylvania Avenue NW
Washington, D.C.
(Address of Principal Executive Office)

20006
(Zip Code)

Registrant's Telephone Number, Including Area Code: (202) 721-6100

Securities Registered Pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange On Which Registered
Common Stock, \$0.0001 par value	New York Stock Exchange Nasdaq Global Select Market

Securities Registered Pursuant to Section 12(g) of the Act:

NONE

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES NO

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

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

The aggregate market value of the registrant's common stock held by non-affiliates of the registrant as of June 30, 2009, was approximately \$609.4 million based upon the last sale price for the registrant's common stock on that date. As of February 25, 2010, there were 179,940,040 shares of the registrant's common stock outstanding.

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PART I

Item 1. *Business.*

General

We are a business development company, or BDC, in the private equity business and we are internally managed. Specifically, we generally invest in primarily private middle market companies with EBITDA, or earnings before interest, taxes, depreciation and amortization, of between \$5 million and \$150 million in a variety of industries through long-term debt and equity capital instruments. As a BDC, we were created to be a source of capital to small and growing businesses in the United States. We have participated in the private equity business since we were founded in 1958. Since then through December 31, 2009, we have invested more than \$14 billion in thousands of companies nationwide. We primarily invest in the American entrepreneurial economy, helping to build middle market businesses and support American jobs. At December 31, 2009, our private finance portfolio included investments in 77 companies that generate aggregate annual revenues of approximately \$8 billion and employ more than 40,000 people. We generally invest in established companies with adequate cash flow for debt service.

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

We are internally managed by our management team of senior officers and managing directors. At December 31, 2009, we had 107 employees. We are headquartered in Washington, DC, with offices in New York, NY and Arlington, VA.

On October 26, 2009, we and Ares Capital Corporation, or Ares Capital, announced a strategic business combination in which ARCC Odyssey Corp., a wholly owned subsidiary of Ares Capital Corporation, or Merger Sub, would merge with and into Allied Capital and, immediately thereafter, Allied Capital would merge with and into Ares Capital. If the merger of Merger Sub into Allied Capital is completed, holders of Allied Capital common stock will have a right to receive 0.325 shares of Ares Capital common stock for each share of Allied Capital common stock held immediately prior to such merger. In connection with such merger, Ares Capital expects to issue a maximum of approximately 58.3 million shares of its common stock (assuming that holders of all in-the-money Allied Capital stock options elect to be cashed out), subject to adjustment in certain limited circumstances. The closing of the merger is subject to the receipt of shareholder approvals from Allied Capital and Ares Capital shareholders, and other closing conditions. Allied Capital is holding a special meeting of its stockholders on March 26, 2010, at which Allied Capital stockholders will be asked to vote on the approval of the merger and the merger agreement described in the proxy statement dated February 11, 2010. Approval of the merger and the merger agreement requires the affirmative vote of two-thirds of Allied Capital's outstanding shares entitled to vote on the matter. The completion of the merger with Ares Capital is dependent on a number of conditions being satisfied or, where legally permissible, waived. See Item IA. Risk Factors Risks Related to the merger with Ares Capital.

Private Equity Investing

The United States and the global economies continue to operate in an unprecedented economic recession, and the U.S. capital markets continue to experience extreme volatility and a lack of liquidity. Our strategy in these difficult economic times has been focused on reducing costs and streamlining our organization; building liquidity through selected asset sales; retaining capital by limiting new investment activity and suspending dividend payments; and working with portfolio companies to help them position for growth when the economy recovers.

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

We have focused on investments in the debt of primarily private middle market companies because they have been structured to provide recurring cash flow to us as the investor. In addition to earning interest income, we may earn income from management, consulting, diligence, structuring or other fees. We may also enhance our total return with capital gains realized from investments in equity instruments or from equity features, such as nominal cost warrants.

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

Private Finance Portfolio. Our private finance portfolio primarily is composed of debt and equity investments. Debt investments include senior loans, unitranche debt (an instrument that combines both senior and subordinated financing, generally in a first lien position), or subordinated debt (with or without equity features). The junior debt that we have in the portfolio is lower in repayment priority than the senior debt and is also known as mezzanine debt. Our portfolio contains equity investments generally for a minority equity stake in portfolio companies, and includes equity features, such as nominal cost warrants, received in conjunction with our debt investments.

Senior loans carry a fixed rate of interest or a floating rate of interest, set as a spread over prime or LIBOR, and generally require payments of both principal and interest throughout the life of the loan. Senior loans generally have contractual maturities of three to six years and interest is generally paid to us monthly or quarterly. Unitranche debt generally carries a fixed rate of interest. Unitranche debt generally requires payments of both principal and interest throughout the life of the loan. Unitranche debt generally has contractual maturities of five to six years and interest generally is paid to us quarterly. Subordinated debt generally carries a fixed rate of interest generally with contractual maturities of five to ten years and generally has interest-only payments in the early years and payments of both principal and interest in the later years, although maturities and principal amortization schedules may vary. Interest on subordinated debt generally is paid to us quarterly.

From time to time, we underwrite or arrange senior loans related to our portfolio investments, or for other companies that are not in our portfolio. At closing, all or a portion of the underwritten commitment may be funded by us, pending sale of the loan to other investors at closing. We generally earn a fee on the senior loans we underwrite or arrange whether or not we fund the underwritten commitment. After completion of the loan sales, we may or may not retain a position in these senior loans. Principal collections include repayments of senior debt funded by us that was subsequently sold by us or refinanced or repaid by the portfolio companies. These transactions may include loan sales to other portfolio companies controlled by us, or funds affiliated with or managed by us.

We also have invested in the bonds and preferred shares/income notes of collateralized loan obligations (CLOs) or collateralized debt obligations (CDOs), where the underlying collateral pool consists primarily of senior loans. Certain of the CLOs and CDOs in which we have invested may be managed by us or Callidus Capital Management, a portfolio company controlled by us.

Our portfolio includes buyout transactions in which we hold investments in senior debt, subordinated debt and equity (preferred and/or voting or non-voting common) where our equity ownership represents a significant portion of the equity, but may or may not represent a controlling interest. If we invest in non-voting equity in a buyout investment, we generally have an option to acquire a controlling stake in the voting securities of the portfolio company at fair market value. Historically, we have structured our buyout investments such that we seek to earn a blended current return on our total capital invested through a combination of interest income on our loans and debt securities, dividends on our preferred and common equity, and management, consulting, or transaction services fees to compensate us for the managerial assistance that we may provide to the portfolio company.

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

At December 31, 2009, 39.1% of the private finance investments at value were in companies more than 25% owned, 8.7% were in companies 5% to 25% owned, and 52.2% were in companies less than 5% owned.

We monitor the portfolio to maintain diversity within the industries in which we invest. We may or may not concentrate in any industry or group of industries in the future. The industry composition of the private finance portfolio at value at December 31, 2009 and 2008, was as follows:

	2009	2008
Industry		
Business services	32%	36%
Consumer products	29	24
Financial services	9	6
CLO/CDO ⁽¹⁾	8	8
Consumer services	5	5
Industrial products	4	5
Education services	3	2
Healthcare services	3	2
Retail	3	5
Private debt funds		5
Other	4	2
Total	100%	100%

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

Commercial Real Estate Finance Portfolio. We also have participated in commercial real estate finance over our history. Over the past several years, we have not actively participated in commercial real estate finance as we believed that the market for commercial real estate had become too aggressive and that investment opportunities were not priced appropriately. As a result, our commercial real estate finance portfolio totaled \$55.8 million at value, or 2.1%

of our total assets, at December 31, 2009, and contained primarily commercial mortgage loans and real estate properties.

Asset Management

In addition to managing our own assets, we manage certain funds that also invest in the debt and equity securities of primarily private middle market companies in a variety of industries and broadly

syndicated senior secured loans. At December 31, 2009, we had six separate funds under our management (together, the Managed Funds) for which we may earn management or other fees for our services. In some cases, we may invest in the equity of these funds, along with other third parties, from which we may earn a current return and/or a future incentive allocation.

In the first quarter of 2009, we completed the acquisition of the management contracts of three middle market senior debt CLOs (together, the Emporia Funds) and certain other related assets for approximately \$11 million (subject to post-closing adjustments). The acquired assets are included in other assets in the accompanying consolidated balance sheet and are being amortized over the life of the contracts. In October 2009, we sold our investment, including our outstanding commitments and the provision of management services, in the Senior Secured Loan Fund LLC to Ares Capital, and in December 2009, we sold our investment, including the provision of management services, in the Allied Capital Senior Debt Fund, L.P. to Ivy Hill Asset Management, L.P., a portfolio company of Ares Capital. We may continue to sell additional Managed Funds to Ares Capital or other third parties.

The assets of the Managed Funds at December 31, 2009 and 2008, and our management fees as of December 31, 2009 were as follows:

(\$ in millions) Name of Fund	Assets of Managed Funds		Management Fee
	December 31, 2009	December 31, 2008	
Knightsbridge CLO 2007-1 Ltd.	\$ 499.3	\$ 500.6	0.600%
Knightsbridge CLO 2008-1 Ltd.	305.1	304.7	0.600%
Emporia Preferred Funding I, Ltd.	417.6		0.625% ⁽¹⁾
Emporia Preferred Funding II, Ltd.	350.5		0.650% ⁽¹⁾
Emporia Preferred Funding III, Ltd.	406.5		0.650% ⁽¹⁾
AGILE Fund I, LLC	73.6	99.3	(1)
Senior Secured Loan Fund LLC ⁽²⁾		789.8	
Allied Capital Senior Debt Fund, L.P. ⁽²⁾		412.9	
Total Assets	\$ 2,052.6	\$ 2,107.3	

⁽¹⁾ In addition to the management fees, we are entitled to an incentive allocation subject to certain performance benchmarks. There can be no assurance that the incentive allocation will be earned.

⁽²⁾ In June 2009, the Unitranche Fund LLC was renamed the Senior Secured Loan Fund LLC. In the fourth quarter of 2009, we sold our investment, including our commitments and the provision of management services, in the Senior Secured Loan Fund LLC to Ares Capital, and we sold our investment, including the provision of management services in the Allied Capital Senior Debt Fund, L.P. to Ivy Hill Asset Management, L.P., a portfolio company of Ares Capital. The Senior Secured Loan Fund LLC earned a fee of 0.375% of assets and the Allied Capital Senior Debt Fund, L.P. earned a fee of 1.625% of the fund's equity.

A portion of the management fees earned by us may be deferred under certain circumstances. Collection of the fees earned is dependent in part on the performance of the relevant fund. We may pay a portion of management fees we receive to Callidus Capital Corporation, a wholly owned portfolio investment, for services provided to the Knightsbridge CLO 2007-1 Ltd., Knightsbridge CLO 2008-1 Ltd. and the Emporia Funds.

Our responsibilities to the Managed Funds may include investment execution, underwriting, and portfolio monitoring services. Each of the Managed Funds may separately invest in the debt or equity of companies in our portfolio, and these investments may be senior, pari passu or junior to the debt and equity investments held by us. We may or may not participate in investments made by the Managed Funds.

For additional discussion of the Managed Funds, see Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations Portfolio and Investment Activity Asset Management .

Business Processes

Business Development. Over the years, we believe we have developed and maintained a strong and extensive network of relationships. This network includes private equity investors, investment banks, business brokers, merger and acquisition advisors, financial services companies, banks, law firms and accountants. We are well known in the private equity industry, and through these relationships, we have been able to source investment opportunities for our portfolio and our Managed Funds.

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

Once a prospective portfolio company is determined to be suitable for investment, we work with the management and the other capital providers, including senior, junior, and equity capital providers, to structure a transaction. Our investments are tailored to the facts and circumstances of each deal. The specific structure is designed to protect our rights and manage our risk in the transaction. We generally structure the debt instrument to require restrictive affirmative and negative covenants, default penalties, or other protective provisions. In addition, each debt investment is individually priced to achieve a return that reflects our rights and priorities in the portfolio company's capital structure, the structure of the debt instrument, and our perceived risk of the investment. Our loans and debt securities have an annual stated interest rate; however, that interest rate is only one factor in pricing the investment. The annual stated interest rate may include some component of contractual payment-in-kind interest, which represents contractual interest accrued and added to the loan balance that generally becomes due at maturity or upon prepayment. In addition to the interest earned on loans and debt securities, our debt investments may include equity features, such as nominal cost warrants or options to buy a minority interest in the portfolio company.

In a buyout transaction where our equity investment represents a significant portion of the equity, our equity ownership may or may not represent a controlling interest. If non-voting equity is invested in a buyout, we generally have an option to acquire a controlling stake in the voting securities of the portfolio company at fair market value.

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

Initial investment screening;

Initial Investment/Finance Committee, or IFC, approval;

Due diligence, structuring and negotiation;

Internal review of diligence results, including peer review;

Final IFC approval;

Approval by the Investment Review Committee of the Board of Directors for all debt investments that represent a commitment equal to or greater than \$20 million and every buyout transaction; and

Funding of the investment.

The IFC is chaired by John Scheurer, CEO, and currently includes William Walton, Chairman of the Board (vice chairman of the committee), Penni Roll, CFO, Scott Binder, Managing Director and Head of

Special Assets, Robert Monk, Managing Director, Daniel Russell, Managing Director and Head of Private Finance, Susan Mayer, Managing Director, Dale Lynch, Executive Vice President, John Wellons, Chief Accounting Officer and two Principals on a rotating basis. The composition of the committee may change from time to time.

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

The Special Assets Sub-Committee of the IFC is responsible for review and oversight of the investment portfolio, including reviewing the performance of selected portfolio companies, overseeing portfolio companies in workout status, reviewing and approving certain modifications or amendments to or certain additional investments in existing portfolio companies, reviewing and approving certain actions by portfolio companies whose voting securities are more than 50% owned by us, reviewing significant investment-related litigation matters where we are a named party, approving related activities and reviewing and approving proxy votes with respect to our portfolio investments.

From time to time, we will identify investments that require closer monitoring or become workout assets. We develop a workout strategy for workout assets and the Special Assets Sub-Committee of the IFC gauges our progress against the strategy. The Special Assets Sub-Committee is chaired by John Scheurer, CEO, and currently includes Scott Binder, Managing Director and Head of Special Assets (vice chairman of the committee), William Walton, Chairman of the Board, Penni Roll, CFO, Daniel Russell, Managing Director and Head of Private Finance, Susan Mayer, Managing Director, and Ralph Blasey, Executive Vice President and Corporate Counsel. The composition of the committee may change from time to time.

For debt investments we may have board observation rights that allow us to attend portfolio company board meetings. For buyout investments, we generally hold a majority of the seats on the board of directors where we own a controlling interest in the portfolio company and we have board observation rights where we do not own a controlling interest in the portfolio company.

Portfolio Valuation

We determine the value of each investment in our portfolio on a quarterly basis, and changes in value result in unrealized appreciation or depreciation being recognized in our statement of operations. Value, as defined in Section 2(a)(41) of the Investment Company Act of 1940 (1940 Act), is (i) the market price for those securities for which a market quotation is readily available and (ii) for all other securities and assets, fair value is as determined in good faith by the Board of Directors. Since there is typically no readily available market value for the investments in our portfolio, we value substantially all of our portfolio investments at fair value as determined in good faith by the Board of Directors in accordance with our valuation policy and the provisions of the 1940 Act and Accounting Standards Codification (ASC) Topic 820, which includes the codification of FASB Statement No. 157, *Fair Value Measurements* and related interpretations. We determine fair value to be the price that would be received for an investment in a current sale, which assumes an orderly transaction between market participants on the measurement date. At December 31, 2009, portfolio investments recorded at fair value using level 3 inputs (as defined under ASC Topic 820) were approximately 80% of our total assets. Because of the

inherent uncertainty of determining the fair value of investments that do not have a readily available market quotation in an active market, the fair value of our investments determined in good faith by the Board of Directors may differ significantly from the values that would have been used had a ready market existed for the investments, and the differences could be material.

There is no single approach for determining fair value in good faith. As a result, determining fair value requires that judgment be applied to the specific facts and circumstances of each portfolio investment while employing a consistently applied valuation process for the types of investments we make. Unlike banks, we are not permitted to provide a general reserve for anticipated loan losses. Instead, we are required to specifically value each individual investment on a quarterly basis. We will record unrealized depreciation on investments when we determine that the fair value of a security is less than its cost basis, and we will record unrealized appreciation when we determine that the fair value is greater than its cost basis. Changes in fair value are recorded in the statement of operations as net change in unrealized appreciation or depreciation. See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations Results of Operations Change in Unrealized Appreciation or Depreciation for a discussion of our valuation methodology.

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

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

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

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

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

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

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

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

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

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

In connection with our valuation process to determine the fair value of a private finance investment, we work with third-party consultants to obtain assistance and advice as additional support in the preparation of our internal valuation

analysis for a portion of the portfolio each quarter. In addition, we may receive other third-party assessments of a particular private finance portfolio company's value in the ordinary course of business, most often in the context of a prospective sale transaction or in the context of a bankruptcy process.

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

We currently intend to continue to work with third-party consultants to obtain valuation assistance for a portion of the private finance portfolio each quarter. We currently anticipate that we will generally obtain valuation assistance for all companies in the portfolio where we own more than 50% of the outstanding voting equity securities (excluding companies with a cost less than \$5.0 million and a value less than \$2.5 million) on a quarterly basis and that we will generally obtain assistance for companies where we own equal to or less than 50% of the outstanding voting equity securities (excluding companies with a cost less than \$5.0 million and a value less than \$2.5 million) at least once during the course of the calendar year. Valuation assistance may or may not be obtained for new companies that enter the portfolio after June 30 of any calendar year during that year or for investments with a cost less than \$5.0 million and value less than \$2.5 million. For the quarter ended December 31, 2009, we received valuation assistance for 59 portfolio companies, which represented 94.6% of the private finance portfolio at value. See Item 7. Management Discussion and Analysis of Financial Condition and Results of Operations below.

Corporate Structure and Offices

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

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

Available Information

Our Internet address is www.alliedcapital.com. We make available free of charge on our website our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. Information contained on our website is not incorporated by reference into this annual report on Form 10-K and you should not consider information contained on our website to be part of this annual report on Form 10-K.

Employees

On December 31, 2009, we employed 107 individuals, including investment and portfolio management professionals, operations professionals and administrative staff. The majority of our employees are located in our Washington, DC office.

Certain Government Regulations

We operate in a highly regulated environment. The following discussion generally summarizes certain government regulations that we are subject to.

Business Development Company. A BDC is defined and regulated by the 1940 Act. A BDC must be organized in the United States for the purpose of investing in or lending to primarily private companies and making managerial assistance available to them. A BDC may use capital provided by public stockholders and from other sources to invest in long-term, private investments in businesses.

As a BDC, we may not acquire any asset other than qualifying assets unless, at the time we make the acquisition, the value of our qualifying assets represent at least 70% of the value of our total assets. The principal categories of qualifying assets relevant to our business are:

Securities purchased in transactions not involving any public offering, the issuer of which is an eligible portfolio company;

Securities received in exchange for or distributed with respect to securities described in the bullet above or pursuant to the exercise of options, warrants or rights relating to such securities; and

Cash, cash items, government securities or high quality debt securities (within the meaning of the 1940 Act), maturing in one year or less from the time of investment.

An eligible portfolio company is generally a domestic company that is not an investment company and that:

does not have a class of securities with respect to which a broker may extend margin credit at the time the acquisition is made;

is controlled by the BDC and has an affiliate of a BDC on its board of directors;

does not have any class of securities listed on a national securities exchange;

public companies that list their securities on a national securities exchange with a market capitalization of less than \$250 million; or

meets such other criteria as may be established by the SEC.

Control, as defined by the 1940 Act, is presumed to exist where a BDC beneficially owns more than 25% of the outstanding voting securities of the portfolio company.

We do not intend to acquire securities issued by any investment company that exceed the limits imposed by the 1940 Act. Under these limits, we generally cannot acquire more than 3% of the voting stock of any investment company (as defined in the 1940 Act), invest more than 5% of the value of our total assets in the securities of one such investment company or invest more than 10% of the value of our total assets in the securities of such investment companies in the aggregate. With regard to that portion of our portfolio invested in securities issued by investment companies, it should be noted that such investments might subject our stockholders to additional expenses.

To include certain securities described above as qualifying assets for the purpose of the 70% test, a BDC must make available to the issuer of those securities significant managerial assistance such as providing significant guidance and

counsel concerning the management, operations, or business objectives and policies of a portfolio company. We offer to provide significant managerial assistance to our portfolio companies.

As a BDC, we are entitled to issue senior securities in the form of stock or senior securities representing indebtedness, including debt securities and preferred stock, as long as each class of senior security has an

asset coverage of at least 200% immediately after each such issuance. In addition, while any senior securities remain outstanding, we must make provisions to prohibit any distribution to our shareholders or repurchase of our common stock unless we meet the applicable asset coverage ratio at the time of the distribution.

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

We are also limited in the amount of stock options that may be issued and outstanding at any point in time. The 1940 Act provides that the amount of a BDC's voting securities that would result from the exercise of all outstanding warrants, options and rights at the time of issuance may not exceed 25% of the BDC's outstanding voting securities, except that if the amount of voting securities that would result from the exercise of all outstanding warrants, options, and rights issued to the BDC's directors, officers, and employees pursuant to any executive compensation plan would exceed 15% of the BDC's outstanding voting securities, then the amount of voting securities that would result from the exercise of all outstanding warrants, options, and rights at the time of issuance shall not exceed 20% of the outstanding voting securities of the BDC.

We may also be prohibited under the 1940 Act from knowingly participating in certain transactions with our affiliates without the prior approval of the members of our Board of Directors who are not interested persons and, in some cases, prior approval by the SEC. We have been granted an exemptive order by the SEC permitting us to engage in certain transactions that would be permitted if we and our subsidiaries were one company and permitting certain transactions among our subsidiaries, subject to certain conditions and limitations.

We have designated a chief compliance officer and established a compliance program pursuant to the requirements of the 1940 Act. We are periodically examined by the SEC for compliance with the 1940 Act.

As with other companies regulated by the 1940 Act, a BDC must adhere to certain substantive regulatory requirements. A majority of our directors must be persons who are not interested persons, as that term is defined in the 1940 Act. Additionally, we are required to provide and maintain a bond issued by a reputable fidelity insurance company to protect us against larceny and embezzlement. Furthermore, as a BDC, we are prohibited from protecting any director or officer against any liability to us or our stockholders arising from willful misfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of such person's office.

We maintain a code of ethics that establishes procedures for personal investment and restricts certain transactions by our personnel. Our code of ethics generally does not permit investment by our employees in securities that have been or are contemplated to be purchased or held by us. Our code of ethics is posted on our website at www.alliedcapital.com and is also filed as an exhibit to our registration statement which is on file with the SEC. You may read and copy the code of ethics at the SEC's Public Reference Room in Washington, D.C. You may obtain information on operations of the Public Reference Room by calling the SEC at 1-800-SEC-0330. In addition, the code of ethics is available on the EDGAR database on the SEC Internet site at <http://www.sec.gov>. You may obtain copies of the code of ethics, after paying a duplicating fee, by electronic request at the following email address: publicinfo@sec.gov, or by writing to the SEC's Public Reference Section, 100 F Street, NE, Washington, D.C. 20549.

We may not change the nature of our business so as to cease to be, or withdraw our election as, a BDC unless authorized by vote of a majority of the outstanding voting securities, as defined in the 1940 Act. A majority of the outstanding voting securities of a company is defined under the 1940 Act as the lesser of: (i) 67% or more of such company's shares present at a meeting if more than 50% of the outstanding shares of such company are present and represented by proxy or (ii) more than 50% of the outstanding shares of such company.

Regulated Investment Company Status. We have elected to be taxed as a regulated investment company (RIC) under Subchapter M of the Code. In order to maintain our status as a RIC and obtain RIC tax benefits, we must, in general, (1) continue to qualify as a BDC; (2) derive at least 90% of our gross income from dividends, interest, gains from the sale of securities and other specified types of income; (3) meet asset diversification requirements as defined in the Code; and (4) timely distribute to stockholders at least 90% of our annual investment company taxable income as defined in the Code. We currently qualify as a RIC. However, there can be no assurance that we will continue to qualify for such treatment in future years. See Item 1A. Risk Factors.

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

Taxable income available for distribution includes investment company taxable income and, to the extent not deemed to be distributed or retained, net long-term capital gains. To the extent that annual taxable income available for distribution exceeds dividends paid or deemed distributed from such taxable income for the year, we may carry over the excess taxable income into the next year and such excess income will be available for distribution in the next year as permitted under the Code. Such excess income will be treated under the Code as having been distributed during the prior year for purposes of our qualification for RIC tax treatment for such year. The maximum amount of excess taxable income that we may carry over for distribution in the next year under the Code is the total amount of dividends paid in the following year, subject to certain declaration and payment guidelines. Excess taxable income carried over and paid out in the next year is generally subject to a nondeductible 4% excise tax.

We could be subject to the Alternative Minimum Tax (AMT) but any items that are treated differently for AMT purposes may be apportioned between us and our stockholders and this may affect U.S. stockholders' AMT liabilities. Although regulations explaining the precise method of apportionment have not yet been issued, such items will generally be apportioned in the same proportion that dividends paid to each stockholder bear to our taxable income (determined without regard to the dividends paid deduction), unless a different method for a particular item is warranted under the circumstances.

Compliance with the Sarbanes-Oxley Act of 2002. The Sarbanes-Oxley Act of 2002 (the Sarbanes-Oxley Act) imposes a wide variety of regulatory requirements on publicly held companies and their insiders. Many of these requirements apply to us, including:

Our Chairman of the Board, Chief Executive Officer, Chief Financial Officer and Chief Accounting Officer certify the financial statements contained in our periodic reports through the filing of Section 302 certifications;

Our periodic reports disclose our conclusions about the effectiveness of our disclosure controls and procedures;

Our annual report on Form 10-K contains a report from our management on internal control over financial reporting, including a statement that our management is responsible for establishing and maintaining adequate internal control over financial reporting as well as our management's assessment of the effectiveness of our internal control over financial reporting, and an attestation report on the effectiveness of our internal control over financial reporting issued by our independent registered public accounting firm;

Our periodic reports disclose whether there were significant changes in our internal control over financial reporting or in other factors that could significantly affect our internal control over financial reporting subsequent to the date of their evaluation, including corrective actions with regard to significant deficiencies and material weaknesses, if any; and

We may not make any loan to any director or executive officer and we may not materially modify any existing loans to any director or executive officer.

We have adopted procedures to comply with the Sarbanes-Oxley Act and the regulations promulgated thereunder. We will continue to monitor our compliance with all future regulations that are adopted under the Sarbanes-Oxley Act and will take actions necessary to ensure that we are in compliance therewith.

We have adopted certain policies and procedures to comply with the New York Stock Exchange (NYSE) corporate governance rules. In accordance with the NYSE procedures, shortly after our 2009 Annual Meeting of Stockholders, we submitted the required CEO certification to the NYSE pursuant to Section 303A.12(a) of the listed company manual. Our common stock is also listed on the Nasdaq Global Select Market.

Item 1A. Risk Factors.

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

Risks Related to Liquidity

Our use of leverage magnifies the potential for gain or loss on amounts invested and may increase the risk of investing in us. Borrowings, also known as leverage, magnify the potential for gain or loss on amounts invested and, therefore, increase the risks associated with investing in our securities. From time to time we borrow from and issue senior debt securities to banks, insurance companies, and other lenders or investors. Holders of these senior securities have fixed dollar claims on our consolidated assets that are superior to the claims of our common stockholders. In the case of the lenders under our \$250 million senior secured term loan (the Term Loan), these claims are secured by a substantial portion of our assets. If the value of our consolidated assets increases, then leveraging would cause the net asset value attributable to our common stock to increase more sharply than it would have

had we not leveraged. Conversely, if the value of our consolidated assets decreases, leveraging would cause net asset value to decline more sharply than it otherwise would have had we not leveraged. Similarly, any increase in our consolidated income in excess of consolidated interest payable on the borrowed funds would cause our net income to increase more than it would without the leverage, while any decrease in our consolidated income would cause net income to decline more sharply than it would have had we not borrowed. Leverage is generally considered a speculative investment technique. We and, indirectly, our stockholders will bear the cost associated with our leverage activity. Our Term Loan contains financial and operating covenants that restrict certain of our business activities, including our ability to declare dividends. Breach of any of those covenants could cause a default under those instruments. Such a default, if not cured or waived, could have a material adverse effect on us.

At December 31, 2009, we had \$1.5 billion of outstanding indebtedness at par bearing a weighted average annual interest cost of 9.8% and a debt to equity ratio of 1.19 to 1.00. If our portfolio of investments fails to produce adequate returns, we may be unable to make interest or principal payments on our indebtedness when they are due. In order for us to cover annual interest payments on indebtedness, we must achieve annual returns on our assets of at least 5.4% as of December 31, 2009, which returns were achieved.

Regulations governing our operation as a BDC affect our ability to, and the way in which we, raise additional debt and equity capital. We will continue to need capital to fund growth in our investments. Under the 1940 Act, we are not permitted to issue indebtedness unless immediately after such borrowing we have an asset coverage for total borrowings of at least 200%. As of December 31, 2009, our asset coverage was 180%. Failure to satisfy the asset coverage requirements of the 1940 Act could have a material adverse impact on our liquidity, financial condition, results of operations, and ability to pay dividends.

We generally are not able to issue and sell our common stock at a price below net asset value per share. We may, however, sell our common stock, warrants, options, or rights to acquire our common stock at a price below the current net asset value per share of the common stock if our Board of Directors determines that such sale is in our best interests and the best interests of our stockholders and, in certain instances, our stockholders approve such sale. In any such case, the price at which our securities are to be issued and sold may not be less than the price which, in the determination of our Board of Directors, closely approximates the market value of such securities (less any commission or discount). If our common stock continues to trade at a discount to net asset value, this restriction could adversely affect our ability to raise capital. Shares of many BDCs, including shares of our common stock, have been trading at discounts to their net asset values. As of December 31, 2009, our net asset value per share was \$6.66. The closing price of our shares on the NYSE at December 31, 2009 was \$3.61. If our common stock trades below net asset value, the higher cost of equity capital may result in it being unattractive to raise new equity, which may limit our ability to grow. The risk of trading below net asset value is separate and distinct from the risk that our net asset value per share may decline.

Our credit ratings may change and may not reflect all risks of an investment in the debt securities. At December 31, 2009 our long-term debt carries a non-investment grade credit rating of B1 by Moody's Investors Service, BB by Standard & Poor's, and B+ by FitchRatings. Our credit ratings are an assessment of our ability to pay our obligations. Consequently, real or anticipated changes in our credit ratings will generally affect the market value of the publicly issued debt securities. There can be no assurance that the long-term debt ratings will be maintained.

Risks Related to the Merger with Ares Capital

As discussed elsewhere in this Annual Report on Form 10-K, we have entered into an agreement to merge with Ares Capital. Our ability to complete the merger is subject to risks and uncertainties,

including, but not limited to, the risk that a condition to closing of the transaction may not be satisfied and the risk that we do not receive stockholder approval. Certain risk factors associated with the merger are set forth below. Additional risks associated with our merger with Ares Capital are set forth under the caption "Risk Factors - Risks Relating to the Merger" in our proxy statement filed with the SEC on February 12, 2010.

On October 26, 2009, we entered into an Agreement and Plan of Merger with Ares Capital Corporation. The merger is subject to closing conditions, including stockholder approval, that, if not satisfied or waived, will result in the merger not being completed, which may result in material adverse consequences to our business and operations. The merger is subject to closing conditions, including the approval of our stockholders that, if not satisfied, will prevent the merger from being completed. The closing condition that our stockholders adopt the merger agreement may not be waived under applicable law and must be satisfied for the merger to be completed. If our stockholders do not adopt the merger agreement and the merger is not completed, the resulting failure of the merger could have a material adverse impact on our business and operations.

Termination of the merger agreement could negatively impact us. If the merger agreement is terminated, there may be various consequences, including:

Our business may have been adversely impacted by the failure to pursue other beneficial opportunities due to the focus of management on the merger, without realizing any of the anticipated benefits of completing the merger;

The market price of our common stock might decline to the extent that the market price prior to termination reflects a market assumption that the merger will be completed;

We may not be able to find a party willing to pay an equivalent or more attractive price than the price Ares Capital has agreed to pay in the merger; and

The payment of any termination fee or reverse termination fee, if required under the circumstances, could adversely affect our financial condition and liquidity.

Under certain circumstances, we are obligated to pay a termination fee or other amounts upon termination of the merger agreement. The merger agreement with Ares Capital contains certain termination rights for Ares Capital and for us and provides that, in connection with the termination of the merger agreement under specified circumstances, we may be required to pay Ares Capital a termination fee of \$30 million (\$15 million if our stockholders do not approve the merger) and Ares Capital may be required to pay us a termination fee of \$30 million. There can be no assurance that the merger will be completed, and the obligation to make that payment may adversely affect our ability to engage in another transaction in the event the merger is not completed and may have an adverse impact on our financial condition.

The merger agreement severely limits our ability to pursue alternatives to the merger. The merger agreement contains "no shop" and other provisions that, subject to limited exceptions, limit our ability to discuss, facilitate or commit to competing third-party proposals to acquire all or a significant part of Allied Capital. These provisions might discourage a potential competing acquiror that might have an interest in acquiring all or a significant part of us from considering or proposing that acquisition even if it were prepared to pay consideration with a higher per share market price than that proposed in the merger. We can consider and participate in discussions and negotiations with respect to an alternative proposal only in very limited circumstances so long as certain notice and other procedural requirements are satisfied. In addition, subject to certain procedural requirements (including the ability of Ares Capital to revise its offer) and the payment of a \$30 million termination fee, we may terminate the merger agreement and enter into an agreement with a third party who makes a superior proposal.

Several lawsuits have been filed against us, members of our Board of Directors, Ares Capital and Merger Sub challenging the merger. An adverse ruling in any such lawsuit may prevent the merger from becoming effective within the expected timeframe or at all. If the merger is consummated, these lawsuits and other legal proceedings could have a material impact on the results of operations, cash flows or financial condition of the combined company. We and Ares Capital are aware that a number of lawsuits have been filed by certain of our stockholders challenging the merger. The suits are filed either as putative stockholder class actions, shareholder derivative actions or both. All of the actions assert similar claims against the members of our Board of Directors alleging that the merger agreement is the product of a flawed sales process and that our directors breached their fiduciary duties by agreeing to a structure that was not designed to maximize the value of our stockholders and by failing to adequately value and obtain fair consideration for our shares. They also claim that Ares Capital (and, in several cases, Merger Sub, and, in several other cases, us) aided and abetted the directors' alleged breaches of fiduciary duties. All of the actions demand, among other things, a preliminary and permanent injunction enjoining the merger and rescinding the transaction or any part thereof that may be implemented. Such legal proceedings could delay or prevent the transaction from becoming effective within the agreed upon timeframe or at all, and, if the merger is consummated, may be material to the results of operations, cash flows or financial condition of the combined company.

We have received unsolicited non-binding acquisition proposals from Prospect Capital Corporation, which may complicate or delay or prevent completion of the merger. Prospect Capital has made unsolicited non-binding acquisition proposals to acquire us and has begun an aggressive campaign to stop the merger with Ares Capital. As part of its campaign, Prospect Capital may attempt to solicit votes against the merger with Ares Capital, which could result in a failure of us to obtain the required stockholder approval. In addition, Prospect Capital's campaign may result in additional lawsuits.

Our Board of Directors and the board of directors of Ares Capital remain committed to the merger. However, there can be no assurance that Prospect Capital's aggressive tactics, or any potential lawsuits related to Prospect Capital's campaign, will not complicate or delay or prevent completion of the merger.

We will be subject to business uncertainties and contractual restrictions while the merger is pending. Uncertainty about the effect of the merger with Ares Capital may have an adverse effect on us and, consequently, on the combined company following completion of the merger. These uncertainties may impair our ability to retain and motivate key personnel until the merger is consummated and could cause those that deal with us to seek to change their existing business relationships with us. Retention of certain employees may be challenging during the pendency of the merger with Ares Capital, as certain employees may experience uncertainty about their future following completion of the merger. If our key employees depart because of issues relating to the uncertainty and difficulty of integration or a desire not to remain affiliated with the combined company following completion of the merger, the combined company's business following the merger could be harmed. In addition, the merger agreement restricts us from taking actions that it might otherwise consider to be in its best interests. These restrictions may prevent us from pursuing certain business opportunities that may arise prior to the completion of the merger.

Risks Related to Current Economic and Market Conditions

The U.S. capital markets are currently in a period of disruption and the United States and global economics are in a severe recession and we do not expect these conditions to improve in the near future. These market conditions have materially and adversely affected the debt and equity capital markets in the United States, which has had and could continue to have a negative impact on our business and operations. The U.S. capital markets have been experiencing extreme volatility and disruption for more than 12 months as evidenced by a lack of liquidity in the debt capital markets, significant write-offs in the financial services sector, the repricing of credit risk in the credit market and

the failure of major financial institutions. These events have contributed to worsening general economic conditions that are materially and adversely impacting the broader financial and credit markets and reducing the availability of credit and equity capital for the markets as a whole and financial services firms in particular. We believe these conditions may continue for a prolonged period of time or worsen in the future. A prolonged period of market illiquidity will continue to have an adverse effect on our business, financial condition, and results of operations. Unfavorable economic conditions also could increase our funding costs, limit our access to the capital markets or result in a decision by lenders not to extend credit to us. Equity capital may be difficult to raise because, subject to some limited exceptions, we generally are not able to issue and sell our common stock at a price below net asset value per share. In addition, the debt capital that will be available, if at all, may be at a higher cost and on less favorable terms and conditions. These events and the inability to raise capital has significantly limited our investment originations and our ability to grow and negatively impacted our operating results.

Economic recessions, including the current global recession, could impair our portfolio companies and harm our operating results. Many of the companies in which we have made or will make investments are susceptible to economic slowdowns or recessions. An economic recession, including the current and any future recessions or economic slowdowns, may affect the ability of a company to repay our loans or engage in a liquidity event such as a sale, recapitalization, or initial public offering. Our nonperforming assets are likely to increase and the value of our portfolio is likely to decrease during these periods. Current adverse economic conditions also have decreased the value of any collateral securing our loans, if any, and a prolonged recession or depression may further decrease such value. These conditions are contributing to and if prolonged could lead to further losses of value in our portfolio and a decrease in our revenues, net income, assets and net worth.

Risks Related to Asset Values

Declining asset values and illiquidity in the corporate debt markets have adversely affected, and may continue to adversely affect, the fair value of our portfolio investments, reducing the value of our assets. As a BDC, we are required to carry our investments at market value or, if no market value is readily available, at fair value as determined in good faith by the Board of Directors. Decreases in the values of our investments are recorded as unrealized depreciation. The unprecedented declines in asset values and liquidity in the corporate debt markets have resulted in significant net unrealized depreciation in our portfolio. Conditions in the debt and equity markets may continue to deteriorate and pricing levels may continue to decline. As a result, we have incurred and, depending on market conditions, we may incur further unrealized depreciation in future periods, which could have a material adverse impact on our business, financial condition and results of operations.

Substantially all of our portfolio investments, which are generally illiquid, are recorded at fair value as determined in good faith by our Board of Directors and, as a result, there is uncertainty regarding the value of our portfolio investments. At December 31, 2009, portfolio investments recorded at fair value were 80% of our total assets. Pursuant to the requirements of the 1940 Act, we value substantially all of our investments at fair value as determined in good faith by our Board of Directors on a quarterly basis. Since there is typically no market quotation in an active market for the investments in our portfolio, our Board of Directors determines in good faith the fair value of these investments pursuant to a valuation policy and a consistently applied valuation process.

There is no single approach for determining fair value in good faith. As a result, determining fair value requires that judgment be applied to the specific facts and circumstances of each portfolio investment while employing a consistently applied valuation process for the types of investments we make. In determining fair value in good faith, we generally obtain financial and other information from portfolio companies, which may represent unaudited, projected or pro forma financial information. Unlike banks, we are not permitted to provide a general reserve for anticipated loan losses; we are instead

required by the 1940 Act to specifically value each individual investment on a quarterly basis. We will record unrealized depreciation on investments when we determine that the fair value of a security is less than its cost basis, and unrealized appreciation when we determine that the fair value of a security is greater than its cost basis. Without a market quotation in an active market and because of the inherent uncertainty of valuation, the fair value of our investments determined in good faith by the Board of Directors may differ significantly from the values that would have been used had a ready market existed for the investments, and the differences could be material. Our net asset value could be affected if our determination of the fair value of our investments is materially different than the value that we ultimately realize.

We adjust quarterly the valuation of our portfolio to reflect the Board of Directors' determination of the fair value of each investment in our portfolio. Any changes in fair value are recorded in our statement of operations as net change in unrealized appreciation or depreciation. See Note 2, Summary of Significant Accounting Policies from our Notes to the Consolidated Financial Statements included in Item 8.

Risks Related to Our Portfolio

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

Our business of making private equity investments and positioning them for liquidity events also may be affected by current and future market conditions. Current economic and capital markets conditions in the United States have severely reduced capital availability, senior lending activity and middle market merger and acquisition activity. The absence of an active senior lending environment and the slowdown or stalling in middle market merger and acquisition activity has slowed the amount of private equity investment activity generally. As a result, our investment activity has also significantly slowed. In addition, significant changes in the capital markets, including the recent extreme volatility and disruption, has had and may continue to have a negative effect on the valuations of our investments, and on the potential for liquidity events involving such investments. This could affect the timing of exit events in our portfolio, reduce the level of net realized gains from exit events in a given year, and negatively affect the amount of gains or losses upon exit.

Investing in private companies involves a high degree of risk. Our portfolio primarily consists of long-term loans to and investments in middle market private companies. Investments in private businesses involve a high degree of business and financial risk, which can result in substantial losses for us in those investments and accordingly should be considered speculative. There is generally no publicly available information about the companies in which we invest, and we rely significantly on the diligence of our employees and agents to obtain information in connection with our investment decisions. If we are unable to identify all material information about these companies, among other factors, we may fail to receive the expected return on our investment or lose some or all of the money invested in these companies. In addition, these businesses may have shorter operating histories, narrower product lines, smaller market shares and less experienced management than their competition and may be more vulnerable to customer preferences, market conditions, loss of key personnel, or economic downturns, which may adversely affect the return on, or the recovery of, our investment in such businesses. As an

investor, we are subject to the risk that a portfolio company may make a business decision that does not serve our interest, which could decrease the value of our investment. Deterioration in a portfolio company's financial condition and prospects may be accompanied by deterioration in the collateral for a loan, if any.

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

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

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

At December 31, 2009, our investment in Ciena Capital LLC (Ciena) totaled \$547.6 million at cost and \$100.1 million at value, after the effect of unrealized depreciation of \$447.5 million. Other assets includes additional amounts receivable from or related to Ciena totaling \$112.7 million, which have a value of \$1.9 million at December 31, 2009. In addition, we have issued a performance guarantee in connection with Ciena's non-recourse warehouse facility. On September 30, 2008, Ciena voluntarily filed for bankruptcy.

Ciena has been a participant in the 7(a) Guaranteed Loan Program of the Small Business Administration (SBA) and its wholly-owned subsidiary is licensed by the SBA as a Small Business Lending Company (SBLC). Ciena remains subject to SBA rules and regulations. The Office of the Inspector General of the SBA (OIG) and the United States Secret Service are conducting ongoing investigations of allegedly fraudulently obtained SBA-guaranteed loans issued by Ciena. Ciena is also subject to other SBA and OIG audits, investigations, and reviews. In addition, the Office of the Inspector General of the U.S. Department of Agriculture is conducting an investigation of Ciena's lending practices under the Business and Industry Loan program. The OIG and the U.S. Department of Justice are also conducting a civil investigation of Ciena's lending practices in various jurisdictions. These investigations, audits, and reviews are ongoing. These investigations, audits, and reviews have had and may continue to have a material adverse impact on Ciena and, as a result, could negatively affect our financial results. We are

unable to predict the outcome of these inquiries and it is possible that third parties could try to seek to impose liability against us in connection with certain defaulted loans in Ciena's portfolio. See Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations - Private Finance, Ciena Capital LLC, and Valuation of Ciena Capital LLC and Item 3. Legal Proceedings.

We operate in a competitive market for investment opportunities. We compete for investments with a large number of private equity funds and mezzanine funds, other BDCs, investment banks, other equity and non-equity based investment funds, and other sources of financing, including specialty finance companies and traditional financial services companies such as commercial banks. Some of our competitors 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.

Risks Related to Regulation as a Business Development Company and Regulated Investment Company

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

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

Changes in the law or regulations that govern us could have a material impact on us or our operations. We are regulated by the SEC. In addition, changes in the laws or regulations that govern BDCs, RICs, asset managers, and real estate investment trusts may significantly affect our business. There are proposals being considered by the current administration to change the regulation of financial institutions that may affect, possibly adversely, investment managers or investment funds. Any change in the laws or regulations that govern our business could have a material impact on us or our operations.

Laws and regulations may be changed from time to time, and the interpretations of the relevant laws and regulations also are subject to change, which may have a material effect on our operations.

Risks Related to Our Ability to Pay Dividends to Our Shareholders

There is a risk that our common stockholders may not receive dividends or distributions. We may not be able to achieve operating results that will allow us to make distributions at a specific level or at all. In addition, due to the asset coverage test applicable to us as a BDC, we may be precluded from making distributions. Also, our Term Loan limits our ability to declare dividends.

If we do not meet the distribution requirements for RICs, we will suffer adverse tax consequences. In addition, in accordance with U.S. generally accepted accounting principles and tax regulations, we include in income certain amounts that we have not yet received in cash, such as contractual payment-in-kind interest, which represents contractual interest added to the loan balance that becomes due at the end of the loan term, or the accrual of original issue discount. The increases in loan balances as a result of contractual payment-in-kind arrangements are included in income in advance of receiving cash payment and are separately included in payment-in-kind interest and dividends, net of cash collections in our consolidated statement of cash flows. Since we may recognize income before or without receiving cash representing such income, we may have difficulty meeting the requirement to distribute at least 90% of our investment company taxable income to obtain tax benefits as a RIC.

Risks Related to Changes in Interest Rates

Changes in interest rates may affect our cost of capital and net investment income. Because we borrow money to make investments, our net investment income is dependent upon the difference between the rate at which we borrow funds and the rate at which we invest these funds. As a result, there can be no assurance that a significant change in market interest rates will not have a material adverse effect on our net investment income. In periods of rising interest rates, our cost of funds would increase, which would reduce our net investment income. In addition, defaults under our borrowing arrangements may result in higher interest costs during the continuance of an event of default. 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.

Risks Related to Asset Management Activities

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

Although Managed Funds may have a different primary investment objective than we do, the Managed Funds may, from time to time, invest in the same or similar asset classes that we target. In addition, more than one fund managed by us may invest in the same or similar asset classes. These investments may be made at the direction of the same individuals acting in their capacity on behalf of us and one or more of the Managed Funds. As a result, there may be conflicts in the allocation of investment opportunities between us and the Managed Funds or among the Managed Funds. We may or may not participate in investments made by funds managed by us or one of our affiliates. See Item 7. Management's Discussion and Analysis and Results of Operations - Managed Funds.

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

Our financial results could be negatively affected if our Managed Funds fail to perform as expected.

In the event that any of our Managed Funds were to perform below our expectations, our financial results could be negatively affected as a result of a reduction in management fees, the deferral in payment of management fees or a reduction in incentive fees we earn. Also, if the Managed Funds perform below expectations, investors could demand lower fees or fee concessions, which could also cause a decline in our income. In addition, certain of our Managed Funds are required to meet various compliance and maintenance tests related to, among other things, the ratings on fund assets and the ratio of collateral to a fund's outstanding debt. If a Managed Fund fails to comply with these tests, the payment of a portion of our fees could be deferred until a fund regains compliance with such tests.

Moreover, because we are also an investor in certain of our Managed Funds, we could experience losses on our investments if such Managed Funds were to fail to perform as expected.

Other Risks

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

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

Our common stock price may be volatile. The trading price of our common stock may fluctuate substantially. The capital and credit markets have been experiencing extreme volatility and disruption since 2007, reaching unprecedented levels. We have experienced significant stock price volatility. In general, the price of the common stock may be higher or lower than the price paid by our stockholders, depending on many factors, some of which are beyond our control and may not be directly related to our operating performance. These factors include, but are not limited to, the following:

price and volume fluctuations in the overall stock market from time to time;

significant volatility in the market price and trading volume of securities of BDCs or other financial services companies;

volatility resulting from trading in derivative securities related to our common stock including puts, calls, long-term equity anticipation securities, or LEAPs, or short trading positions;

the financial performance of the specific industries in which we invest on a recurring basis;

changes in laws or regulatory policies or tax guidelines with respect to BDCs or RICs;

actual or anticipated changes in our earnings or fluctuations in our operating results or changes in the expectations of securities analysts;

general economic conditions and trends;

loss of a major funding source; or

departures of key personnel.

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

the time remaining to the maturity of these debt securities;

the outstanding principal amount of debt securities with terms identical to these debt securities;

the ratings assigned by national statistical ratings agencies;

the general economic environment;

the supply of debt securities trading in the secondary market, if any;

the redemption or repayment features, if any, of these debt securities;

the level, direction and volatility of market interest rates generally; and

market rates of interest higher or lower than rates borne by the debt securities.

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

Our common stock could be delisted from the NYSE if we trade below \$1.00 or if we fail to meet other listing criteria. In order to maintain our listing on the NYSE, we must continue to meet the minimum share price listing rule, the minimum market capitalization rule and other continued listing criteria. Under the NYSE continued listing criteria, the average closing price of our common stock must not be below \$1.00 per share for 30 or more consecutive trading days. In the event that the average closing price of our common stock is below \$1.00 per share over a consecutive 30-day trading period, we would have a six-month cure period to attain both a \$1.00 share price and a \$1.00 average share price over 30 trading days.

If our common stock were delisted, it could (i) reduce the liquidity and market price of our common stock; (ii) negatively impact our ability to raise equity financing and access the public capital markets; and (iii) materially adversely impact our results of operations and financial condition.

Item 1B. Unresolved Staff Comments

Not applicable.

Item 2. *Properties.*

Our principal offices are located at 1919 Pennsylvania Avenue, N.W., Washington, DC 20006-3434. Our lease for approximately 59,000 square feet of office space at that location expires in December 2010 with an option to renew until 2015. The office is equipped with an integrated network of computers for word processing, financial analysis, accounting and loan servicing. We believe our office space is suitable for our needs for the foreseeable future. We also maintain offices in New York, NY and Arlington, VA.

Item 3. *Legal Proceedings.*

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

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

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

On February 26, 2007, Dana Ross filed a class action complaint in the U.S. District Court for the District of Columbia in which she alleges that Allied Capital Corporation and certain members of management violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. Thereafter, the court appointed new lead counsel and approved new lead plaintiffs. On July 30, 2007, plaintiffs served an amended complaint. Plaintiffs claim that, between November 7, 2005, and January 22, 2007, Allied Capital either failed to disclose or misrepresented information about our portfolio company, Business Loan Express, LLC. Plaintiffs sought unspecified compensatory and other damages, as well as other relief. On September 13, 2007, we filed a motion to dismiss the lawsuit. On November 4, 2009, the motion to dismiss was granted.

A number of lawsuits have been filed against us, our Board of Directors and Ares Capital Corporation. These include: (1) *In re Allied Capital Corporation Shareholder Litigation*, Case No. 322639-V (Circuit Court for Montgomery County, Maryland); (2) *Sandler v. Walton, et al.*, Case No. 2009 CA 008123 B (Superior Court for the District of Columbia); (3) *Wienecki v. Allied Capital Corporation, et al.*, Case No. 2009 CA 008541 B (Superior Court for the District of Columbia); and (4) *Ryan v. Walton, et al.*, Case No. 1:10-CV-00145-RMC (United States District Court for the District of Columbia). The suits were filed after the announcement of the merger with Ares Capital on October 26, 2009 either as putative stockholder class actions, shareholder derivative actions or both. All of the actions assert similar claims alleging that our Board of Directors failed to discharge adequately its fiduciary duties to shareholders by failing to adequately value our shares and ensure that our shareholders received adequate consideration in a proposed sale of Allied Capital to Ares Capital Corporation, that the proposed merger between us and Ares Capital is the product of a flawed sales process, that our directors and officers breached their fiduciary duties by agreeing to a structure that was not designed to maximize the value of Allied's shares, and that Ares Capital aided and abetted the alleged breach of fiduciary duty. The plaintiffs demand, among other things, a preliminary and permanent injunction enjoining the sale and rescinding the transaction or any part thereof that has been implemented. We believe that each of the lawsuits is without merit.

In addition to the above matters, we are party to certain lawsuits in the normal course of business. Furthermore, third parties may try to seek to impose liability on us in connection with the activities of our portfolio companies. For a discussion of civil investigations being conducted regarding the lending practices of Ciena Capital LLC, one of our portfolio companies, see Note 3, *Portfolio Ciena Capital LLC* from our Notes to the Consolidated Financial Statements included in Item 8.

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

Item 4. *Submission of Matters to a Vote of Security Holders.*

No matters were submitted to a vote of stockholders during the fourth quarter of 2009.

PART II

Item 5. *Market For Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.*

Our common stock is traded on the New York Stock Exchange under the trading symbol ALD as its primary listing and is also traded on the Nasdaq Global Select Market. As of February 22, 2010, there are approximately 3,500 shareholders of record and approximately 118,000 beneficial shareholders of the Company. The quarterly stock prices quoted below represent interdealer quotations and do not include markups, markdowns, or commissions and may not necessarily represent actual transactions.

Quarterly Stock Prices for 2009 and 2008

	2009				2008			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
High	\$ 4.80	\$ 4.02	\$ 4.05	\$ 3.82	\$ 23.26	\$ 21.52	\$ 15.97	\$ 10.00
Low	\$ 0.59	\$ 1.48	\$ 2.81	\$ 2.73	\$ 18.38	\$ 13.89	\$ 10.80	\$ 1.59
Close	\$ 1.59	\$ 3.48	\$ 3.07	\$ 3.61	\$ 18.43	\$ 13.89	\$ 10.80	\$ 2.69

Dividend Declarations

We have not declared any dividends since the fourth quarter of 2008. The following table summarizes our dividends declared during 2008:

Date Declared	Record Date	Payment Date	Amount
February 1, 2008	March 12, 2008	March 27, 2008	\$ 0.65
April 25, 2008	June 13, 2008	June 27, 2008	\$ 0.65
July 8, 2008	September 12, 2008	September 26, 2008	\$ 0.65
July 8, 2008	December 12, 2008	December 26, 2008	\$ 0.65
Total declared for 2008			\$ 2.60

See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Other Matters and Dividends and Distributions and Note 10, Dividends and Distributions and Taxes from our Notes to the Consolidated Financial Statements included in Item 8. For 2008, we paid \$456.5 million or \$2.60 per share in dividends to stockholders. Dividends for 2008 were paid primarily from taxable income carried forward from 2007 for distribution in 2008.

We have elected to be taxed as a RIC under Subchapter M of the Code. As a RIC, we are required to distribute substantially all of our investment company taxable income to stockholders through the payment of dividends. In certain circumstances, we are restricted in our ability to pay dividends. Our Term Loan contains provisions that limit our ability to declare dividends. In addition, pursuant to the 1940 Act, we may be precluded from declaring dividends or other distributions to our shareholders unless our asset coverage is at least 200%.

As of December 31, 2009, we estimate that we have no dividend distribution requirements for the 2009 tax year. We intend to retain capital in 2010, and we would be able to carry forward 2010 taxable income, if any, for distribution in 2011. There can be no certainty as to future dividends. We currently qualify as a RIC; however there can be no assurance that we will be able to comply with the RIC requirements to distribute income, if any, for 2010 or other future years and we may be required to pay a corporate level income tax. See Certain Government Regulations Regulated Investment Company Status.

Performance Graph

This graph compares the return on our common stock with that of the Standard & Poor's 500 Stock Index and the Dow Jones Financial Index, for the years 2005 through 2009. The graph assumes that, on December 31, 2004, a person invested \$100 in each of our common stock, the S&P 500 Stock Index, and the Dow Jones Financial Index. The graph measures total shareholder return, which takes into account both changes in stock price and dividends. It assumes that dividends paid are reinvested in like securities.

Shareholder Return Performance Graph Five-Year Cumulative Total Return⁽¹⁾ (Through December 31, 2009)

⁽¹⁾ Total return includes reinvestment of dividends through December 31, 2009.

Sales of Unregistered Securities

During 2009, we did not pay any dividends to our stockholders and, therefore, did not issue any shares of common stock pursuant to our dividend reinvestment plan. This plan is not registered and relies on an exemption from registration under the Securities Act of 1933. See Note 6, Shareholders' Equity from our Notes to the Consolidated Financial Statements included in Item 8.

Item 6. Selected Financial Data.**SELECTED CONDENSED CONSOLIDATED FINANCIAL DATA**

You should read the condensed consolidated financial information below with the Consolidated Financial Statements and Notes thereto included herein. The financial information below has been derived from our financial statements that were audited by KPMG LLP.

(in thousands, except per share data)	Year Ended December 31,				
	2009	2008	2007	2006	2005
Operating Data:					
Interest and related portfolio income:					
Interest and dividends	\$ 290,986	\$ 457,418	\$ 417,576	\$ 386,427	\$ 317,153
Fees and other income	27,700	43,694	44,129	66,131	56,999
 Total interest and related portfolio income	 318,686	 501,112	 461,705	 452,558	 374,152
Expenses:					
Interest	171,068	148,930	132,080	100,600	77,352
Employee	42,104	76,429	89,155	92,902	78,300
Employee stock options ⁽¹⁾	3,355	11,781	35,233	15,599	
Administrative	38,147	49,424	50,580	39,005	69,713
Impairment of long-lived asset	2,873				
 Total operating expenses	 257,547	 286,564	 307,048	 248,106	 225,365
 Net investment income before income taxes	 61,139	 214,548	 154,657	 204,452	 148,787
Income tax expense, including excise tax	5,576	2,506	13,624	15,221	11,561
 Net investment income	 55,563	 212,042	 141,033	 189,231	 137,226
 Net realized and unrealized gains (losses):					
Net realized gains (losses)	(361,128)	(129,418)	268,513	533,301	273,496
Net change in unrealized appreciation or (depreciation)	(176,689)	(1,123,762)	(256,243)	(477,409)	462,092
 Total net gains (losses)	 (537,817)	 (1,253,180)	 12,270	 55,892	 735,588
 Gain on repurchase of debt	 83,532	 1,132			
Loss on extinguishment of debt	(122,776)				

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Net increase (decrease) in net assets resulting from operations	\$ (521,498)	\$ (1,040,006)	\$ 153,303	\$ 245,123	\$ 872,814
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Per Share:

Diluted earnings (loss) per common share	\$ (2.91)	\$ (6.01)	\$ 0.99	\$ 1.68	\$ 6.36
Net investment income plus net realized gains (losses) per share ⁽²⁾	\$ (1.71)	\$ 0.48	\$ 2.65	\$ 4.96	\$ 2.99
Dividends per common share ⁽²⁾	\$	\$ 2.60	\$ 2.64	\$ 2.47	\$ 2.33
Weighted average common shares outstanding	178,994	172,996	154,687	145,599	137,274
diluted					

(in thousands, except per share data)	At December 31,				
	2009	2008	2007	2006	2005
Balance Sheet Data:					
Portfolio at value	\$ 2,131,118	\$ 3,492,950	\$ 4,780,521	\$ 4,496,084	\$ 3,606,355
Total assets	2,665,497	3,722,186	5,214,576	4,887,505	4,025,880
Total debt outstanding ⁽³⁾	1,426,011	1,945,000	2,289,470	1,899,144	1,284,790
Undistributed (distributions in excess of) earnings	(159,250)	184,715	535,853	502,163	112,252
Shareholders' equity	1,198,202	1,718,400	2,771,847	2,841,244	2,620,546
Shareholders' equity per common share (net asset value) ⁽⁴⁾	\$ 6.66	\$ 9.62	\$ 17.54	\$ 19.12	\$ 19.17
Common shares outstanding at end of year	179,940	178,692	158,002	148,575	136,697

	Year Ended December 31,				
	2009	2008	2007	2006	2005
Other Data:					
Investments funded	\$ 130,436	\$ 1,078,171	\$ 1,845,973	\$ 2,437,828	\$ 1,675,773
Principal collections related to investment repayments or sales	1,069,677	1,053,894	1,226,855	1,055,347	1,503,388
Realized gains	52,655	150,468	400,510	557,470	343,061
Realized losses	(413,783)	(279,886)	(131,997)	(24,169)	(69,565)

(in thousands, except per share data)	2009				2008			
	Qtr 4	Qtr 3	Qtr 2	Qtr 1	Qtr 4	Qtr 3	Qtr 2	Qtr 1
Quarterly Data (unaudited):								
Net interest and related portfolio income	\$ 66,436	\$ 72,438	\$ 84,630	\$ 95,182	\$ 100,928	\$ 120,662	\$ 134,578	\$ 144,940
Net investment income (loss)	231	9,585	18,233	27,514	33,043	45,595	63,855	69,540
Net increase (decrease) in net assets resulting from operations	(4,082)	(140,683)	(29,063)	(347,670)	(578,829)	(318,262)	(102,203)	(40,710)
Adjusted earnings (loss) per common share	\$ (0.02)	\$ (0.79)	\$ (0.16)	\$ (1.95)	\$ (3.24)	\$ (1.78)	\$ (0.59)	\$ (0.20)
Dividends declared per common share ⁽⁵⁾					0.65	0.65	0.65	0.65
Net asset value per common share ⁽⁴⁾	6.66	6.70	7.49	7.67	9.62	13.51	15.93	16.90

- (1) Effective January 1, 2006, we adopted the provisions of ASC Topic 718, *Compensation - Stock Compensation*, which codified Statement No. 123 (Revised 2004), *Share-Based Payment*. See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations below.
- (2) Dividends are based on taxable income, which differs from income for financial reporting purposes. Net investment income and net realized gains (losses) have been the most significant components of our annual taxable income from which dividends have been paid. See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations below.
- (3) See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations for more information regarding our level of indebtedness.
- (4) We determine net asset value per common share as of the last day of the period presented. The net asset values shown are based on outstanding shares at the end of each period presented.
- (5) Dividends paid in 2008 primarily were paid from taxable income earned in 2007 that was carried over for distribution in 2008. See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations below.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The information contained in this section should be read in conjunction with our Consolidated Financial Statements and the Notes thereto. In addition, this annual report on Form 10-K contains certain forward-looking statements. These statements include the plans and objectives of management for future operations and financial objectives and can be identified by the use of forward-looking terminology such as may, will, expect, intend, anticipate, estimate, or continue or the negative thereof or other variations thereon or comparable terminology. These forward-looking statements are subject to the inherent uncertainties in predicting future results and conditions. Certain factors that could cause actual results and conditions to differ materially from those projected in these forward-looking statements are set forth above in Part I. Item 1A. Risk Factors. Other factors that could cause actual results to differ materially include:

changes in the economy, including economic downturns or recessions;

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

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

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

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

OVERVIEW

We are a business development company, or BDC, in the private equity business and we are internally managed. Specifically, we primarily invest in private middle market companies in a variety of industries through long-term debt and equity capital instruments. Our financing generally is used to fund buyouts, acquisitions, growth, recapitalizations, note purchases, and other types of financings. Our investment objective is to achieve current income and capital gains.

The United States and the global economies continue to operate in an unprecedented economic recession and the U.S. capital markets continue to experience volatility and a lack of liquidity. Our strategy in these difficult times has been focused on reducing costs and streamlining our organization; building liquidity through selected asset sales; retaining capital by limiting new investment activity and suspending dividend payments; and working with portfolio companies to help them position for growth when the economy recovers.

Our portfolio composition at December 31, 2009, 2008, and 2007, was as follows:

	2009	2008	2007
Private finance	97%	97%	97%
Commercial real estate finance	3%	3%	3%

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

In addition to managing our own assets, we manage certain funds that also invest in the debt and equity securities of primarily private middle market companies in a variety of industries. At December 31, 2009, we had six separate funds under our management (together, the Managed Funds) for which we may earn management or other fees for our services. In some cases, we have invested in the equity of these funds, along with other third parties, from which we may earn a current return and/or a future incentive allocation. At December 31, 2009, the funds that we manage had total assets of approximately \$2.1 billion. During the fourth quarter of 2009, we sold our investment, including our outstanding commitments and the provision of management services, in the Senior Secured Loan Fund LLC to Ares Capital, and we sold our investment, including the provision of management services, in the Allied Capital Senior Debt Fund, L.P. to Ivy Hill Asset Management, L.P., a portfolio company of Ares Capital. We may continue to sell additional Managed Funds. See [Managed Funds](#) below for further discussion.

In aggregate, including the total assets on our balance sheet and capital committed to our Managed Funds, we had \$4.6 billion in managed capital at December 31, 2009.

On October 26, 2009, we and Ares Capital Corporation, or [Ares Capital](#), announced a strategic business combination in which [ARCC Odyssey Corp.](#), a wholly owned subsidiary of [Ares Capital](#), or [Merger Sub](#), would merge with and into [Allied Capital](#) and, immediately thereafter, [Allied Capital](#) would merge with and into [Ares Capital](#). If the merger of [Merger Sub](#) into [Allied Capital](#) is completed, holders of [Allied Capital](#) common stock will have a right to receive 0.325 shares of [Ares Capital](#) common stock for each share of [Allied Capital](#) common stock held immediately prior to such merger. In connection with such merger, [Ares Capital](#) expects to issue a maximum of approximately 58.3 million shares of its common stock (assuming that holders of all in-the-money [Allied Capital](#) stock options elect to be cashed out), subject to adjustment in certain limited circumstances. The closing of the merger is subject to the receipt of shareholder approvals from [Allied Capital](#) and [Ares Capital](#) shareholders, and other closing conditions. [Allied Capital](#) is holding a special meeting of its stockholders on March 26, 2010, at which [Allied Capital](#) stockholders will be asked to vote on the approval of the merger and the merger agreement described in the proxy statement dated February 11, 2010. Approval of the merger and the merger agreement requires the affirmative vote of two-thirds of [Allied Capital](#)'s outstanding shares entitled to vote on the matter. The completion of the merger with [Ares Capital](#) is dependent on a number of conditions being satisfied or, where legally permissible, waived. See [Item 1A. Risk Factors](#) [Risks Related to the Merger with Ares Capital](#).

PORTFOLIO AND INVESTMENT ACTIVITY

The total portfolio at value, investment activity, and the yield on interest-bearing investments at and for the years ended December 31, 2009, 2008, and 2007, were as follows:

(\$ in millions)	At and for the Years Ended December 31,		
	2009	2008	2007
Portfolio at value	\$ 2,131.1	\$ 3,493.0	\$ 4,780.5
Investments funded	\$ 130.4	\$ 1,078.2	\$ 1,846.0
Payment-in-kind interest and dividends, net of cash collections	\$ 33.8	\$ 53.4	\$ 12.0
Principal collections related to investment repayments or sales ⁽¹⁾	\$ 1,069.7	\$ 1,053.9	\$ 1,226.9
Yield on interest-bearing investments ⁽²⁾	11.6%	12.1%	12.1%

(1) Principal collections related to investment repayments or sales for the years ended December 31, 2009, 2008 and 2007, included collections of \$9.7 million, \$383.0 million and \$221.9 million, respectively, related to the sale of investments to certain of our Managed Funds. See **Managed Funds** below for further discussion. Principal collections related to investment repayments or sales for the years ended December 31, 2009, 2008 and 2007 included \$198.4 million, \$16.5 million and \$15.3 million, respectively, of cash collections of notes and other securities received from the sale of investments in portfolio companies in prior periods.

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

Private Finance

The private finance portfolio at value, investment activity, and the yield on interest-bearing investments at and for the years ended December 31, 2009, 2008, and 2007, were as follows:

(\$ in millions)	At and for the Years Ended December 31,					
	2009		2008		2007	
	Value	Yield ⁽¹⁾	Value	Yield ⁽¹⁾	Value	Yield ⁽¹⁾
Portfolio at value:						
Loans and debt securities:						
Senior loans	\$ 278.9	4.9%	\$ 306.3	5.6%	\$ 344.3	7.7%
Unitranche debt	360.4	12.9%	456.4	12.0%	653.9	11.5%
Subordinated debt	1,051.3	13.4%	1,829.1	12.9%	2,416.4	12.8%
Total loans and debt securities	1,690.6	11.9%	2,591.8	11.9%	3,414.6	12.1%
Equity securities:						
Preferred shares/income notes of CLOs ⁽²⁾	86.4	8.0%	179.2	16.4%	203.0	14.6%
Subordinated certificates in Unitranche Fund LLC ⁽²⁾			125.4	12.0%	0.7	12.4%
Other equity securities	298.3		502.7		1,041.0	
Total equity securities	384.7		807.3		1,244.7	
Total portfolio	\$ 2,075.3		\$ 3,399.1		\$ 4,659.3	
Investments funded	\$ 127.5		\$ 1,068.1		\$ 1,828.0	
Payment-in-kind interest and dividends, net of cash collections	\$ 32.9		\$ 53.2		\$ 12.7	
Principal collections related to investment repayments or sales ⁽³⁾	\$ 1,063.5		\$ 1,037.1		\$ 1,203.5	

(1) The weighted average yield on loan and debt securities is computed as the (a) annual stated interest on accruing loans and debt securities plus the annual amortization of loan origination fees, original issue discount, and market discount on accruing loans and debt securities less the annual amortization of loan origination costs, divided by (b) total loans and debt securities at value. The weighted average yield on the preferred shares/income notes of CLOs is calculated as the (a) effective interest yield on the preferred shares/income notes of CLOs, divided by (b) preferred shares/income notes of CLOs at value. The weighted average yield on the subordinated certificates in the Senior Secured Loan Fund LLC is computed as the (a) effective interest yield divided by (b) total investment at value. The weighted average yields are computed as of the balance sheet date. See Results of Operations Total Interest and Related Portfolio Income below for discussion of the portfolio yield.

(2)

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

- (3) Includes \$198.4 million, \$16.5 million and \$15.3 million of cash collections during the years ended December 31, 2009, 2008 and 2007, respectively, related to notes and other securities received from the sale of investments in prior periods. Also includes collections from the sale or repayment of senior loans totaling \$94.4 million, \$285.3 million and \$393.4 million for the years ended December 31, 2009, 2008, and 2007, respectively.

Our private finance portfolio primarily is composed of debt and equity investments. Debt investments include senior loans, unitranche debt (an instrument that combines both senior and subordinated financing, generally in a first lien position), or subordinated debt (with or without equity features). The junior debt that we have in the portfolio is lower in repayment priority than senior debt and is also known as mezzanine debt. Our portfolio contains equity investments for a minority equity stake in portfolio companies and includes equity features such as nominal cost warrants received in conjunction with our debt investments. In a buyout transaction, we generally invest in senior and/or subordinated debt and equity (preferred and/or voting or non-voting common) where our equity ownership represents a significant portion of the equity, but may or may not represent a controlling interest.

Investment Activity. Investments funded and the weighted average yield on interest-bearing investments funded for the years ended December 31, 2009, 2008, and 2007, consisted of the following:

(\$ in millions)	2009 Investments Funded					
	Debt Investments		Buyout Investments		Total	
	Amount	Weighted Average Yield (1)	Amount	Weighted Average Yield (1)	Amount	Weighted Average Yield (1)
Loans and debt securities:						
Senior loans	\$ 43.2	6.1%	\$ 9.7	1.0%	\$ 52.9	5.1%
Unitranche debt ⁽²⁾	1.0	9.5%		%	1.0	9.5%
Subordinated debt	3.0	15.0%	3.3	18.0%	6.3	16.5%
Total loans and debt securities	47.2	6.7%	13.0	5.3%	60.2	6.4%
Subordinated Certificates in Senior Secured Loan Fund LLC ⁽³⁾	47.4	8.4%			47.4	8.4%
Equity	9.5		10.4		19.9	
Total	\$ 104.1		\$ 23.4		\$ 127.5	
(\$ in millions)	2008 Investments Funded					
	Debt Investments		Buyout Investments		Total	
	Amount	Weighted Average Yield (1)	Amount	Weighted Average Yield (1)	Amount	Weighted Average Yield (1)
Loans and debt securities:						
Senior loans	\$ 175.9	7.4%	\$ 13.9	5.4%	\$ 189.8	7.2%
Senior secured loan to Ciena Capital LLC			319.0	0.0% ⁽⁴⁾	319.0	0.0% ⁽⁴⁾
Unitranche debt ⁽²⁾	15.3	10.5%	0.5	6.6%	15.8	10.4%
Subordinated debt	246.4 ⁽⁵⁾	12.6%	54.8	15.4%	301.2	13.1%
Total loans and debt securities	437.6	10.4%	388.2	2.4%	825.8	6.6% ⁽⁷⁾
Preferred shares/income notes of CLOs ⁽⁶⁾	35.6	18.6%			35.6	18.6%
Subordinated certificates in Senior Secured Loan Fund LLC	124.7	10.9%			124.7	10.9%
Equity	40.5		41.5		82.0	
Total	\$ 638.4		\$ 429.7		\$ 1,068.1	

**2007 Investments Funded
Buyout**

(\$ in millions)	Debt Investments		Investments		Total	
	Amount	Weighted Average Yield ⁽¹⁾	Amount	Weighted Average Yield ⁽¹⁾	Amount	Weighted Average Yield ⁽¹⁾
Loans and debt securities:						
Senior loans	\$ 249.0	9.2%	\$ 63.1	8.8%	\$ 312.1	9.1%
Unitranche debt ⁽³⁾	109.1	10.8%	74.9	13.0%	184.0	11.7%
Subordinated debt	719.4 ⁽⁵⁾	12.8%	197.6	12.1%	917.0	12.6%
Total loans and debt securities	1,077.5	11.7%	335.6	11.7%	1,413.1	11.7%
Preferred shares/income notes of CLOs ⁽⁶⁾	116.2	16.4%			116.2	16.4%
Subordinated certificates in Senior Secured Loan Fund LLC Equity	0.7	12.4%			0.7	12.4%
	152.0 ⁽⁸⁾		146.0		298.0	
Total	\$ 1,346.4		\$ 481.6		\$ 1,828.0	

- (1) The weighted average yield on interest-bearing investments is computed as the (a) annual stated interest on accruing interest-bearing investments, divided by (b) total interest-bearing investments, funded. The weighted average yield on the preferred shares/income notes of CLOs is calculated as the (a) effective interest yield on the preferred shares/income notes of CLOs, divided by (b) preferred shares/income notes of CLOs funded. The weighted average yield on the subordinated certificates in the Senior Secured Loan Fund LLC is computed as the (a) effective interest yield on the subordinated certificates divided by (b) total investments at value. The weighted average yield is calculated using yields as of the date an investment is funded.
- (2) Unitranche debt is an investment that combines both senior and subordinated financing, generally in a first lien position. The yield on a unitranche investment reflects the blended yield of senior and subordinated debt.
- (3) In June 2009, the Unitranche Fund LLC was renamed the Senior Secured Loan Fund LLC. In October 2009, we sold our investment, including our outstanding commitments and the provision of management services in the Senior Secured Loan Fund LLC to Ares Capital.
- (4) The senior secured loan to Ciena acquired on September 30, 2008, was placed on non-accrual status on the purchase date.

- (5) Subordinated debt investments for the years ended December 31, 2008 and 2007, included \$43.8 million and \$45.3 million, respectively, in investments in the bonds of collateralized loan obligations (CLOs). Certain of these CLOs are managed by Callidus Capital Corporation (Callidus), a portfolio company controlled by us. These CLOs primarily invest in senior corporate loans.
- (6) CLO equity investments included preferred shares/income notes of CLOs that primarily invest in senior corporate loans. Certain of these CLOs are managed by us or by Callidus.
- (7) Excluding the senior secured loan to Ciena, the weighted average yield on new investments for the year ended December 31, 2008, was 10.8%.
- (8) Equity investments for the year ended December 31, 2007, included \$31.8 million invested in the Allied Capital Senior Debt Fund, L.P.

For the year ended December 31, 2009, we made private finance investments totaling \$127.5 million. Investments arose primarily from fundings under revolving line of credit instruments and \$47.4 million to fund investments made by the Senior Secured Loan Fund LLC. Historically, our focus for investments generally has been on higher return junior debt capital investments. Senior loans funded by us generally were funded with the intent to sell the loan or for the portfolio company to refinance the loan at some point in the future as discussed below. We have made fewer direct unitranche debt investments since the establishment of the Senior Secured Loan Fund LLC in the fourth quarter of 2007. Unitranche loans sourced by us in these periods generally were referred to the Senior Secured Loan Fund. In October 2009, we sold our investment, including our outstanding commitments and the provision of management services in the Senior Secured Loan Fund LLC to Ares Capital.

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

We may underwrite or arrange senior loans related to our portfolio investments or for other companies that are not in our portfolio. When we underwrite or arrange senior loans, we may earn a fee for such activities. Senior loans underwritten or arranged by us may be funded by us at closing. When these senior loans are closed, we may fund all or a portion of the underwritten commitment pending sale of the loan to other investors, which may include loan sales to the Managed Funds or funds managed by Callidus Capital Corporation (Callidus), a wholly owned portfolio company. After completing loan sales, we may retain a position in these senior loans. We generally earn a fee on the senior loans we underwrite or arrange whether or not we fund the underwritten commitment. In addition, we may fund most or all of the debt and equity capital upon the closing of certain buyout transactions, which may include investments in lower-yielding senior debt. Subsequent to the closing, the portfolio company may refinance all or a portion of the lower-yielding senior debt, which would reduce our investment.

We have focused our efforts on selling assets in our portfolio to generate capital. Principal collections related to private finance investment repayments or sales were \$1.1 billion for the year ended December 31, 2009, including \$198.4 million of cash collections related to notes and other receivables received from the sale of investments in portfolio companies in prior periods. Principal collections include repayments of senior debt funded by us that was subsequently sold by us or refinanced or repaid by the portfolio companies. We plan to continue to sell assets and re-balance our portfolio with an emphasis on current income. However, there can be no assurance that we will be able to achieve these objectives.

Outstanding Investment Commitments. During 2009, our new investing activities were sharply reduced, and our investing activities were primarily focused on funding existing outstanding investment commitments.

At December 31, 2009, we had outstanding private finance investment commitments as follows:

(\$ in millions)	Companies		Companies		Total
	More Than 25% Owned ⁽¹⁾	Companies 5% to 25% Owned	Less Than 5% Owned		
Senior loans	\$ 17.0	\$ 6.0	\$ 58.2	\$ 81.2 ⁽²⁾	
Unitranche debt	3.0		11.6	14.6	
Subordinated debt	10.1	4.3		14.4	
Total loans and debt securities	30.1	10.3	69.8	110.2	
Equity securities	11.0	7.0	18.5	36.5 ⁽³⁾	
Total	\$ 41.1	\$ 17.3	\$ 88.3	\$ 146.7	

(1) Includes a \$4.0 million revolving line of credit commitment for working capital to Callidus Capital Corporation (Callidus), a portfolio company controlled by us, which owns 100% of Callidus Capital Management, LLC, an asset management company that structures and manages collateralized loan obligations (CLOs), collateralized debt obligations (CDOs), and other related investments.

(2) Includes \$80.6 million in the form of revolving senior debt facilities to 18 companies.

(3) Includes \$24.4 million to 7 private equity and venture capital funds. These fund commitments are generally drawn over a multi-year period of time as the funds make investments.

Total commitments were \$146.7 million at December 31, 2009. Commitments were reduced from \$648.7 million at December 31, 2008, primarily due to the sale of the Senior Secured Loan Fund LLC, including our outstanding commitments and the provision of management services in October 2009 to Ares Capital.

In addition to these outstanding investment commitments at December 31, 2009, we also had outstanding guarantees to private finance portfolio companies. See *Financial Condition, Liquidity and Capital Resources* below. We intend to fund these commitments with existing cash and through cash flows from operations before new investments, although there can be no assurance that we will generate sufficient cash flows to satisfy these commitments.

Net Unrealized Depreciation on Private Finance Portfolio. At December 31, 2009, our private finance portfolio totaled \$3.6 billion at cost and \$2.1 billion at value, which included net unrealized depreciation of \$1.5 billion. \$0.9 billion or 61.3% of the total net unrealized depreciation of \$1.5 billion was related to our investments in three portfolio companies and our investment in CLO/CDO Assets as follows: \$447.5 million or 29.2% related to our investment in Ciena Capital, LLC; \$214.1 million or 14.0% related to investments in CLO/CDO Assets; \$186.8 million or 12.2% related to our investment in EarthColor, Inc.; and \$91.2 million or 5.9% related to our investment in Hot Stuff Foods, LLC.

Investments in Collateralized Loan Obligations and Collateralized Debt Obligations (CLO/CDO Assets). At December 31, 2009 and 2008, we had investments in CLO issuances and a CDO bond, which totaled as follows:

(\$ in millions)	Cost	2009 Value	Yield ⁽¹⁾	Cost	2008 Value	Yield ⁽¹⁾
CLO/CDO bonds ⁽²⁾	\$ 130.3	\$ 72.7	12.5%	\$ 127.7	\$ 86.1	18.5%
Preferred shares/income notes of CLOs	242.9	86.4	8.0%	248.2	179.2	16.4%
Total	\$ 373.2	\$ 159.1		\$ 375.9	\$ 265.3	
Percentage of total assets		6.0%			7.1%	

⁽¹⁾ The weighted average yield is calculated as the (a) annual stated interest or the effective interest yield on the accruing bonds or the effective interest yield on the preferred shares/income notes, divided by (b) CLO and CDO assets at value. The market yield used in the valuation of the CLO and CDO assets may be different than the interest yields shown above. See discussion below.

⁽²⁾ Included in private finance subordinated debt.

The CLO and CDO issuances in which we have invested are primarily invested in senior corporate loans. Certain of these funds are managed by Callidus, and certain of these funds are managed by us. See also Note 3, Portfolio from our Notes to the Consolidated Financial Statements included in Item 8. During the first quarter of 2010, Callidus entered into an agreement to sell the management contracts related to the funds it manages.

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

The CLO/CDO Assets in which we have invested are junior in priority for payment of interest and principal to the more senior notes issued by the CLOs and CDO. Cash flow from the underlying collateral assets in the CLOs and CDO is generally allocated first to the senior bonds in order of priority, then any remaining cash flow generally is distributed to the preferred shareholders and income note holders. To the extent there are ratings downgrades, defaults, and unrecoverable losses on the underlying collateral assets that result in reduced cash flows, the preferred shares/income notes will bear this loss first and then the subordinated bonds would bear any loss after the preferred shares/income notes. At both December 31, 2009 and 2008, the face value of the CLO and CDO assets held by us was subordinate to as much as 94% of the face value of the securities outstanding in these CLOs and CDO.

At December 31, 2009 and 2008, the underlying collateral assets of these CLO and CDO issuances, consisting primarily of senior corporate loans, were issued by 626 issuers and 658 issuers, respectively, and had balances as follows:

(\$ in millions)	2009	2008
Bonds	\$ 229.3	\$ 268.3

Syndicated loans	4,313.8	4,477.3
Cash ⁽¹⁾	156.2	89.6
Total underlying collateral assets ⁽²⁾	\$ 4,699.3	\$ 4,835.2

(1) Includes undrawn liability amounts.

(2) At December 31, 2009 and 2008, the total face value of defaulted obligations was \$148.6 million and \$95.0 million, respectively, or approximately 3.5% and 2.0%, respectively, of the total underlying collateral assets.

Market yields for investments in CLO preferred shares/income notes increased throughout 2008 and into 2009, and, as a result, the fair value of certain of our investments in these assets decreased. At December 31, 2009, the market yield used to value our preferred shares/income notes ranged from 27.5% to 31.5%. In the current economic environment, we expect ratings downgrades, defaults and losses to continue to remain high, and we have also considered this in our valuation analysis. Ratings agencies have continued to downgrade the underlying collateral in these types of structures regardless of the payment status of the loan or debt security. Net change in unrealized appreciation or depreciation for the years ended December 31, 2009 and 2008, included a net decrease of \$103.9 million and \$94.7 million, respectively, related to our investments in CLO/CDO Assets. We received third-party valuation assistance for our investments in the CLO/CDO Assets in each quarter of 2009. See Results of Operations Valuation Methodology Private Finance below for further discussion of the third-party valuation assistance we received.

As the debt capital markets show significant volatility, yield spreads may widen further. As a result, if the market yields for our investments in CLOs continue to increase or should the performance of the underlying assets in the CLOs decrease or additional ratings downgrades occur, the fair value of our investments may decrease further.

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

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

As a result of Ciena's decision to file for bankruptcy protection, our unconditional guaranty of the obligations outstanding under Ciena's revolving credit facility became due and, in lieu of paying under our guarantee, we purchased the positions of the senior lenders under Ciena's revolving credit facility. As of December 31, 2009, the senior secured loan to Ciena had a cost basis of \$319.0 million and a value of \$100.1 million. We continue to guarantee the remaining principal balance of \$5 million, plus related interest, fees and expenses payable to a third party bank. In connection with our continuing guaranty of the amounts held by this bank, we have agreed that the amounts owing to the bank under the Ciena revolving credit facility will be paid before any of the secured obligations of Ciena now owed to us.

At December 31, 2009 and 2008, our investment in Ciena was as follows:

(\$ in millions)	2009		2008	
	Cost	Value	Cost	Value
Senior Loan	\$ 319.0	\$ 100.1	\$ 319.0	\$ 104.9
Class B Equity Interests ⁽¹⁾	119.5		119.5	
Class C Equity Interests ⁽¹⁾	109.1		109.3	
Total	\$ 547.6	\$ 100.1	\$ 547.8	\$ 104.9

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

In addition to our investment in Ciena included in the portfolio, we have amounts receivable from or related to Ciena that are included in other assets in the accompanying consolidated financial statements. See below.

During the year ended December 31, 2009, we funded \$97.4 million to support Ciena's term securitizations in lieu of draws under related standby letters of credit. This was required primarily as a result of the issuer of the letters of credit not extending maturing standby letters of credit that were issued under our former revolving line of credit. The amounts funded were recorded as other assets in the accompanying consolidated balance sheet. At December 31, 2009 and 2008, other assets includes amounts receivable from or related to Ciena totaling \$112.7 million and \$15.4 million at cost and \$1.9 million and \$2.1 million at value, respectively. Net change in unrealized appreciation or depreciation included a net decrease of \$102.0 million and \$174.5 million for the years ended December 31, 2009 and 2007, respectively, related to our investment in and receivables from Ciena. Net change in unrealized appreciation or depreciation for the year ended December 31, 2008, included a decrease in our investment in Ciena totaling \$296.0 million and the reversal of unrealized depreciation of \$99.0 million associated with the realized loss on the sale of our Class A equity interests. See "Valuation of Ciena Capital LLC" below.

At December 31, 2009, we had no outstanding standby letters of credit issued under our former revolving line of credit. We have considered the letters of credit and the funding thereof in the valuation of Ciena at December 31, 2009.

Our investment in Ciena was on non-accrual status, therefore we did not earn any interest and related portfolio income from our investment in Ciena for each of the years ended December 31, 2009 and 2008.

At December 31, 2009, Ciena had one non-recourse SBA loan warehouse facility, which has reached its maturity date but remains outstanding. Ciena is working with the providers of the SBA loan warehouse facility with regard to the repayment of that facility. We have issued a performance guaranty whereby we agreed to indemnify the warehouse providers for any damages, losses, liabilities and related costs and expenses that they may incur as a result of Ciena's failure to perform any of its obligations as loan originator, loan seller or loan servicer under the warehouse facility.

The Office of the Inspector General of the SBA (OIG) and the United States Secret Service are conducting ongoing investigations of allegedly fraudulently obtained SBA guaranteed loans issued by Ciena.

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

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

Commercial Real Estate Finance

The commercial real estate finance portfolio at value, investment activity, and the yield on interest-bearing investments at and for the years ended December 31, 2009, 2008, and 2007, were as follows:

(\$ in millions)	At and for the Years Ended December 31,					
	2009		2008		2007	
	Value	Yield ⁽¹⁾	Value	Yield ⁽¹⁾	Value	Yield ⁽¹⁾
Portfolio at value:						
Commercial mortgage loans	\$ 35.4	5.1%	\$ 53.5	7.4%	\$ 65.4	6.8%
Real estate owned	6.4		20.8		21.3	
Equity interests	14.0		19.6		34.5	
Total portfolio	\$ 55.8		\$ 93.9		\$ 121.2	
Investments funded	\$ 2.9		\$ 10.1		\$ 18.0	
Payment-in-kind interest, net of cash collections	\$ 0.9		\$ 0.2		\$ (0.7)	
Principal collections related to investment repayments or sales	\$ 6.2		\$ 16.8		\$ 23.4	

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

At December 31, 2009, we had outstanding funding commitments related to the commercial real estate portfolio of \$7.1 million.

Managed Funds

In addition to managing our own assets, we manage certain funds that also invest in the debt and equity securities of primarily private middle market companies in a variety of industries and broadly syndicated senior secured loans. At December 31, 2009, we had six separate funds under our management (together, the Managed Funds) for which we may earn management or other fees for our services. In some cases, we have invested in the equity of these funds, along with other third parties, from which we may earn a current return and/or a future incentive allocation.

In the first quarter of 2009, we completed the acquisition of the management contracts of three middle market senior debt CLOs (together, the Emporia Funds) and certain other related assets for approximately \$11 million (subject to post-closing adjustments). The acquired assets are included in other assets in the accompanying consolidated balance sheet and are being amortized over the life of the contracts. During the fourth quarter of 2009, we sold our investment, including our outstanding commitments and the provision of management services, in the Senior Secured Loan Fund LLC to Ares Capital, and we sold our investment, including the provision of management services, in the Allied Capital Senior Debt Fund, L.P. to Ivy Hill Asset Management, L.P., a portfolio company of Ares Capital. We may continue to sell additional Managed Funds to Ares Capital or to other third parties.

The assets of the Managed Funds at December 31, 2009 and 2008, and our management fees as of December 31, 2009 were as follows:

(\$ in millions) Name of Fund	Assets of Managed Funds December 31,		Management Fee
	2009	2008	
Knightsbridge CLO 2007-1 Ltd.	\$ 499.3	\$ 500.6	0.600%
Knightsbridge CLO 2008-1 Ltd.	305.1	304.7	0.600%
Emporia Preferred Funding I, Ltd.	417.6		0.625% ⁽¹⁾
Emporia Preferred Funding II, Ltd.	350.5		0.650% ⁽¹⁾
Emporia Preferred Funding III, Ltd.	406.5		0.650% ⁽¹⁾
AGILE Fund I, LLC	73.6	99.3	(1)
Senior Secured Loan Fund LLC ⁽²⁾		789.8	
Allied Capital Senior Debt Fund, L.P. ⁽²⁾		412.9	
Total Assets	\$ 2,052.6	\$ 2,107.3	

(1) In addition to the management fees, we are entitled to an incentive allocation subject to certain performance benchmarks. There can be no assurance that the incentive allocation will be earned.

(2) In June 2009, the Unitranche Fund LLC was renamed the Senior Secured Loan Fund LLC. In the fourth quarter of 2009, we sold our investment, including our commitments and the provision of management services, in the Senior Secured Loan Fund LLC to Ares Capital, and we sold our investment, including the provision of management services in the Allied Capital Senior Debt Fund, L.P. to Ivy Hill Asset Management, L.P., a portfolio company of Ares Capital. The Senior Secured Loan Fund LLC earned a fee of 0.375% of assets and the Allied Capital Senior Debt Fund, L.P. earned a fee of 1.625% of the fund's equity.

A portion of the management fees earned by us may be deferred under certain circumstances. Collection of the fees earned is dependent in part on the performance of the relevant fund. We may pay a portion of management fees we receive to Callidus Capital Corporation, a wholly owned portfolio investment, for services provided to the Knightsbridge CLO 2007-1 Ltd., Knightsbridge CLO 2008-1 Ltd. and the Emporia Funds.

Our responsibilities to the Managed Funds may include investment execution, underwriting, and portfolio monitoring services. Each of the Managed Funds may separately invest in the debt or equity of companies in our portfolio, and these investments may be senior, pari passu or junior to the debt and equity investments held by us. We may or may not participate in investments made by the Managed Funds.

During the year ended December 31, 2009, we sold assets to certain of the Managed Funds for which we received proceeds of \$9.7 million and we recognized a net realized gain of \$6.3 million. During the year ended December 31, 2008, we sold assets to certain of the Managed Funds, for which we received proceeds of \$383.0 million, and we recognized realized gains of \$8.3 million.

In addition to managing these funds, we hold certain investments in the Managed Funds at December 31, 2009 and 2008 as follows:

(\$ in millions) Name of Fund	Investment Description	2009		2008	
		Cost	Value	Cost	Value
Senior Secured Loan Fund LLC ⁽¹⁾	Subordinated Certificates and Equity Interests	\$	\$	\$ 125.4	\$ 125.4
Allied Capital Senior Debt Fund, L.P. ⁽¹⁾	Equity interests			31.8	31.8
Knightsbridge CLO 2007-1 Ltd.	Class E Notes and Income Notes	57.9	27.6	59.6	50.1
Knightsbridge CLO 2008-1 Ltd.	Class C Notes, Class D Notes, Class E Notes and Income Notes	54.0	50.2	52.7	52.7
AGILE Fund I, LLC	Equity Interests	0.6	0.4	0.7	0.5
Total		\$ 112.5	\$ 78.2	\$ 270.2	\$ 260.5

⁽¹⁾ In the fourth quarter of 2009, we sold our investment, including our outstanding commitments and the provision of management services, in the Senior Secured Loan Fund LLC. to Ares Capital, and we sold our investment, including the provision of management services, in the Allied Capital Senior Debt Fund, LP. to Ivy Hill Asset Management, L.P., a portfolio company of Ares Capital.

PORTFOLIO ASSET QUALITY

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

At December 31, 2009 and 2008, loans and debt securities at value not accruing interest for the total investment portfolio were as follows:

(\$ in millions)	2009		2008	
	Cost	Value	Cost	Value
Private finance				
Companies more than 25% owned	\$ 528.3	\$ 177.1	\$ 612.9	\$ 176.1
Companies 5% to 25% owned	58.7	16.0	10.6	
Companies less than 5% owned	270.3	47.4	350.0	151.8
Commercial real estate finance	9.4	6.1	5.1	7.7

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Total	\$ 866.7	\$ 246.6	\$ 978.6	\$ 335.6
Total portfolio	\$ 3,685.1	\$ 2,131.1	\$ 4,962.9	\$ 3,493.0
Percentage of total portfolio	23.5%	11.6%	19.7%	9.6%

Because the size of our portfolio has decreased from \$3.5 billion at December 31, 2008, to \$2.1 billion at December 31, 2009, the percentage of loans on non-accrual has increased despite the decrease in the value of loans and debt securities on non-accrual.

At December 31, 2009 and 2008, private finance non-accruals included our senior secured debt in Ciena, which was \$100.1 million or 4.7% of the total portfolio at value and \$104.9 million or 3.0% of total portfolio at value, respectively. The Ciena senior secured loan was acquired in the third quarter of 2008, and was placed on non-accrual status upon its purchase. See Private Finance Ciena Capital LLC above.

Loans and Debt Securities Over 90 Days Delinquent. Loans and debt securities greater than 90 days delinquent at value at December 31, 2009 and 2008, were as follows:

(\$ in millions)	2009	2008
Private finance	\$171.6	\$106.6
Commercial mortgage loans	4.2	1.4
Total	\$175.8	\$108.0
Total portfolio at value	\$2,131.1	\$3,493.0
Percentage of total portfolio	8.2%	3.1%

At December 31, 2009 and 2008, loans and debt securities over 90 days delinquent included our senior secured debt in Ciena, which was \$100.1 million or 4.7% of the total portfolio at value and \$104.9 million or 3.0% of total portfolio at value, respectively. The Ciena senior secured loan was acquired in the third quarter of 2008 and was placed on non-accrual status upon its purchase. See Private Finance Ciena Capital LLC above.

The amount of the portfolio that is on non-accrual status or greater than 90 days delinquent may vary from year to year. Loans and debt securities on non-accrual status and over 90 days delinquent should not be added together as they are two separate measures of portfolio asset quality. Loans and debt securities that are in both categories (i.e., on non-accrual status and over 90 days delinquent) totaled \$139.9 million and \$108.0 million at December 31, 2009 and 2008, respectively.

RESULTS OF OPERATIONS**Comparison of the Years Ended December 31, 2009, 2008, and 2007**

The following table summarizes our operating results for the years ended December 31, 2009, 2008, and 2007.

(except per share amounts)	2009	2008	Change	Percent Change	2008	2007	Change
Related Portfolio Income							
Dividends	\$ 290,986	\$ 457,418	\$ (166,432)	(36)%	\$ 457,418	\$ 417,576	\$ 39,842
Other income	27,700	43,694	(15,994)	(37)%	43,694	44,129	(429)
and related portfolio income	318,686	501,112	(182,426)	(36)%	501,112	461,705	39,407
	171,068	148,930	22,138	15%	148,930	132,080	16,850
	42,104	76,429	(34,325)	(45)%	76,429	89,155	(12,726)
Warrant options	3,355	11,781	(8,426)	(72)%	11,781	35,233	(23,452)
	38,147	49,424	(11,277)	(23)%	49,424	50,580	(1,156)
Long-lived asset	2,873		2,873	**			
Operating expenses	257,547	286,564	(29,017)	(10)%	286,564	307,048	(20,484)
Income before income taxes	61,139	214,548	(153,409)	(72)%	214,548	154,657	59,891
Expense, including excise tax	5,576	2,506	3,070	123%	2,506	13,624	(11,118)
Income	55,563	212,042	(156,479)	(74)%	212,042	141,033	71,009
and Unrealized Gains (Losses)							
Net gains (losses)	(361,128)	(129,418)	(231,710)	179%	(129,418)	268,513	(397,931)
Net unrealized appreciation or	(176,689)	(1,123,762)	947,073	*	(1,123,762)	(256,243)	(867,519)
Net (losses)	(537,817)	(1,253,180)	715,363	*	(1,253,180)	12,270	(1,265,450)
Reclassification of debt	83,532	1,132	82,400	**	1,132		1,132
Amortization of debt	(122,776)		(122,776)	**			
Net income (loss)	\$ (521,498)	\$ (1,040,006)	\$ 518,508	(50)%	\$ (1,040,006)	\$ 153,303	\$ (1,193,309)
Net income (loss) per common share	\$ (2.91)	\$ (6.01)	\$ 3.10	(52)%	\$ (6.01)	\$ 0.99	\$ (7.00)
Weighted average common shares							
Basic	178,994	172,996	5,998	3%	172,996	154,687	18,309

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

** Comparison not meaningful.

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

Interest and Dividends. Interest and dividend income for the years ended December 31, 2009, 2008, and 2007, was composed of the following:

(\$ in millions)	2009	2008	2007
Interest			
Private finance loans and debt securities	\$ 248.2	\$ 393.3	\$ 376.1
Preferred shares/income notes of CLOs	14.3	34.1	18.0
Subordinated certificates in Senior Secured Loan Fund LLC	13.7	8.3	
Commercial mortgage loans	3.5	4.1	6.4
Cash, U.S. Treasury bills, money market and other securities	0.5	4.4	15.1
Total interest	280.2	444.2	415.6
Dividends	10.8	13.2	2.0
Total interest and dividends	\$ 291.0	\$ 457.4	\$ 417.6

The level of interest income, which includes interest paid in cash and in kind, is directly related to the balance of the interest-bearing investment portfolio outstanding during the year multiplied by the weighted average yield. The interest-bearing investments in the portfolio at value and the yield on the interest-bearing investments in the portfolio at December 31, 2009, 2008, and 2007, were as follows:

(\$ in millions)	2009		2008		2007	
	Value	Yield ⁽¹⁾	Value	Yield ⁽¹⁾	Value	Yield ⁽¹⁾
Private finance:						
Loans and debt securities:						
Senior loans	\$ 278.9	4.9%	\$ 306.3	5.6%	\$ 344.3	7.7%
Unitranche debt	360.4	12.9%	456.4	12.0%	653.9	11.5%
Subordinated debt	1,051.3	13.4%	1,829.1	12.9%	2,416.4	12.8%
Equity securities:						
Preferred shares/income notes of CLOs	86.4	8.0%	179.2	16.4%	203.0	14.6%
Subordinated certificates in Senior Secured Loan Fund LLC			125.4	12.0%	0.7	12.4%
Commercial real estate:						
Commercial mortgage loans	35.4	5.1%	53.5	7.4%	65.4	6.8%
Total interest-bearing investments	\$ 1,812.4	11.6%	\$ 2,949.9	12.1%	\$ 3,683.7	12.1%

- (1) The weighted average yield on loans and debt securities is computed as the (a) annual stated interest on accruing loans and debt securities plus the annual amortization of loan origination fees, original issue discount, and market discount on accruing loans and debt securities less the annual amortization of loan origination costs, divided by (b) total interest-bearing investments at value. The weighted average yield on the preferred shares/income notes of CLOs is calculated as the (a) effective interest yield on the preferred shares/income notes of CLOs, divided by (b) preferred shares/income notes of CLOs at value. The weighted average yield on the subordinated certificates in the Senior Secured Loan Fund LLC is computed as the (a) annual effective interest yield divided by (b) total investment at value. This yield excludes any return from the potential future excess cash flows from portfolio earnings available to the subordinated certificate holders and from related structuring fees and management and sourcing fees. See Fees and Other Income below. The weighted average yields are computed as of the balance sheet date.

Interest income has decreased over the 2008 period primarily as a result of decreases in the aggregate size of the interest-bearing portfolio due to the disposition of certain investments as we have been selectively selling assets from our portfolio in order to generate capital to repay our indebtedness and de-lever our balance sheet. Because we recently have exited, and in the future intend to exit several interest-bearing investments in order to accumulate capital for repayment of debt, we expect that income from our interest-bearing investments will continue to decrease in 2010.

Dividend income results from the dividend yield on preferred equity interests, if any, or the declaration of dividends by a portfolio company on preferred or common equity interests. Dividend income for the year ended December 31, 2009, was \$10.8 million as compared to \$13.2 million for the year ended December 31, 2008. Dividend income for 2009 includes a \$7.7 million dividend received in

connection with the sale of Amerex Group LLC. Dividend income for 2008 includes a \$3.1 million dividend received in connection with the recapitalization of Norwesco, Inc., and \$6.4 million of dividends received in connection with the sale to AGILE Fund I, LLC. Dividend income will vary from year to year depending upon the timing and amount of dividends that are declared or paid by a portfolio company on preferred or common equity interests.

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

Fees and other income for the years ended December 31, 2009, 2008, and 2007, included fees relating to the following:

(\$ in millions)	2009	2008	2007
Structuring and diligence	\$ 1.5	\$ 19.2	\$ 20.7
Management, consulting and other services provided to portfolio companies	7.3	11.4	9.6
Commitment, guaranty and other fees from portfolio companies ⁽¹⁾	3.0	6.3	9.3
Fund management fees ⁽²⁾	14.9	6.1	0.5
Loan prepayment premiums	0.9	0.6	3.7
Other income	0.1	0.1	0.3
Total fees and other income	\$ 27.7	\$ 43.7	\$ 44.1

⁽¹⁾ Includes guaranty and other fees from Ciena of \$0, \$0, and \$5.4 million for 2009, 2008 and 2007, respectively. See Private Finance Ciena Capital LLC above.

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

Fees and other income generally are related to specific transactions or services and therefore may vary substantially from year to year depending on the level of investment activity and the types of services provided and the level of assets in Managed Funds for which we earn management or other fees. The increase in fund management fees for the year ended December 31, 2009 as compared to the year ended December 31, 2008 was due to an increase in assets under management related to our Managed Funds. The amount of fund management fees is directly based on the amount of assets under management. During the fourth quarter of 2009, we sold our interests, including our outstanding commitments and the provision of management services, in the Senior Secured Loan Fund LLC to Ares Capital, and we sold our interests, including the provision of management services, in the Allied Capital Senior Debt Fund, L.P. to Ivy Hill Asset Management, L.P., a portfolio company of Ares Capital. For the year ended December 31, 2009, fee income related to the Senior Secured Loan Fund and Allied Capital Senior Debt Fund was approximately \$4.8 million. Despite the increase in management fees for the year ended December 31, 2009, fees and other income were lower for the year ended December 31, 2009 than for the year ended December 31, 2008 due to the significant decrease in our investment activity. Loan origination fees that represent yield enhancement on a loan are capitalized and amortized into interest income over the life of the loan. Given our outlook for future investment

activity for our balance sheet as well as for certain Managed Funds, we expect that fee income in 2010 will reflect lower new investment levels and a decrease in assets under management.

Private finance investments funded were \$127.5 million for the year ended December 31, 2009, as compared to \$1.1 billion and \$1.8 billion for the years ended December 31, 2008 and 2007, respectively. Structuring and diligence fees primarily relate to the level of new investment originations, which were lower in 2009 than 2008. Structuring and diligence fees for the year ended December 31, 2008, included \$10.4 million earned by us in connection with investments made by the Senior Secured Loan Fund, LLC. See

Managed Funds above. Because we expect new investment activity to continue at a low level, we expect structuring and diligence fees to continue to be low in 2010.

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

Interest Expense. The fluctuations in interest expense during the years ended December 31, 2009, 2008, and 2007, primarily were attributable to changes in the level of our borrowings under various notes payable and our revolving line of credit as well as an increase in our weighted average cost of debt capital. Our contractual borrowing activity and weighted average cost of debt, including fees and debt financing costs, at and for the years ended December 31, 2009, 2008, and 2007, were as follows:

(\$ in millions)	2009	2008	2007
Total outstanding debt at par	\$ 1,459.8	\$ 1,945.0	\$ 2,289.5
Average outstanding debt	\$ 1,766.2	\$ 2,091.6	\$ 1,924.2
Weighted average cost ⁽¹⁾	9.8%	7.7%	6.5%

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

At the end of the fourth quarter of 2008, we amended our private notes and revolving line of credit, which increased the stated interest rate on those obligations by 100 basis points. Subsequent to this amendment, events of default occurred on these instruments. Pursuant to the terms of the revolving credit facility, during the continuance of an event of default, the applicable spread on any borrowings outstanding and fees on any letters of credit outstanding under the revolving credit facility increased by up to an additional 200 basis points. Pursuant to the private notes, during the continuance of an event of default, the rate of interest borne by the private notes increased by an additional 200 basis points. During the year ended December 31, 2009, we incurred additional interest expense totaling \$12.0 million related to the default interest. On August 28, 2009, we completed a restructuring of our private notes and bank facility, which significantly increased our cost of capital. On January 29, 2010, we repaid the private notes and bank facility in full and entered into a new \$250 million senior secured term loan. See Financial Condition, Liquidity and Capital Resources below.

In addition, interest expense included interest paid to the Internal Revenue Service related to installment sale gains totaling \$6.3 million, \$7.7 million, and \$5.8 million for the years ended December 31, 2009, 2008, and 2007, respectively. See Dividends and Distributions below.

Employee Expense. Employee expenses for the years ended December 31, 2009, 2008, and 2007, were as follows:

(\$ in millions)	2009	2008	2007
Salaries and employee benefits	\$ 42.1	\$ 63.2	\$ 83.9
Individual performance award (IPA)		8.5	9.8
IPA mark to market expense (benefit)		(4.1)	(14.0)
Individual performance bonus (IPB)		8.8	9.5

Total employee expense ⁽¹⁾	\$ 42.1	\$ 76.4	\$ 89.2
Number of employees at end of period	107	152	177

⁽¹⁾ Excludes stock options expense. See below.

During the second half of 2008, we consolidated our investment execution activities to our Washington, D.C. headquarters and our office in New York in an effort to improve operating efficiencies and reduced headcount by approximately 50 employees. During the third quarter of 2009, we further reduced headcount by approximately 22 employees. For 2009, we accrued \$7.5 million in bonuses and \$0.3 million in performance awards as compared to \$1.0 million in bonuses and \$11.2 million in performance awards accrued in 2008. In order to retain key personnel through the closing date of the

merger with Ares Capital, we will pay the 2009 bonuses as retention bonuses on the earlier of April 15, 2010 or the closing date of the merger with Ares Capital. An employee must be employed on the payment date in order to receive the retention bonus. Our Chairman of the Board, Chief Executive Officer and Chief Financial Officer received no performance or retention bonus for 2009.

The IPA and IPB were part of an incentive compensation program for certain officers in prior years and were generally determined annually at the beginning of each year. We did not establish an IPA or IPB for 2009 or for 2010 as part of our efforts to reduce employee expense. In 2008, IPAs were paid in cash in two equal installments during the year. The IPB was distributed in cash to award recipients throughout the year.

Stock Options Expense. The stock option expense for the years ended December 31, 2009, 2008 and 2007, was as follows:

(\$ in millions)	2009	2008	2007
Employee Stock Option Expense:			
Options granted:			
Previously awarded, unvested options as of January 1, 2006	\$	\$ 3.9	\$ 10.1
Options granted on or after January 1, 2006	3.4	7.9	10.7
Total options granted	3.4	11.8	20.8
Options cancelled in connection with tender offer (see below)			14.4
Total employee stock option expense	\$ 3.4	\$ 11.8	\$ 35.2

In addition to employee stock option expense, administrative expense included \$0.1 million, \$0.1 million and \$0.2 million for the years ended December 31, 2009, 2008, and 2007, respectively, for options granted to non-officer directors. Options granted to non-officer directors vest on the grant date and therefore, the full expense is recorded on the grant date.

We estimate that the employee-related stock option expense will be approximately \$3.9 million, \$3.9 million and \$0.0 million for the years ended December 31, 2010, 2011 and 2012, respectively. This estimate does not include any expense related to stock option grants after December 31, 2009, as the fair value of those stock options will be determined at the time of grant. This estimate may change if our assumptions related to future option forfeitures change.

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

In accordance with the terms of the tender offer, the Weighted Average Market Price represented the volume weighted average price of our common stock over the fifteen trading days preceding the first day of the offer period, or June 20, 2007. Because the Weighted Average Market Price at the commencement of the tender offer on June 20, 2007, was higher than the market price of our common stock at the close of the offer on July 18, 2007, SFAS 123R, which has been codified into ASC Topic 718, *Compensation - Stock Compensation*, required us to record a non-cash employee-related stock option expense of \$14.4 million and administrative expense related to stock options cancelled that were held by non-officer directors of \$0.4 million. The same amounts were recorded as an increase to additional paid-in capital and, therefore, had no effect on our net asset value. The portion of the OCP paid in cash of \$52.8 million

reduced our additional paid-in capital and therefore reduced our net asset value. For income tax purposes, our tax deduction resulting from the OCP will be similar to the tax deduction that would have resulted from an exercise of stock options in the market. Any tax deduction resulting from the OCP or an exercise of stock options in the market is limited by Section 162(m) of the Code.

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

Administrative expenses were \$38.1 million, \$49.4 million and \$50.6 million for the years ended December 31, 2009, 2008 and 2007 respectively. The decrease is primarily due to our focus on reducing costs. Administrative expenses for the year ended December 31, 2009 include costs of \$6.0 million related to the merger with Ares Capital. We will continue to incur costs related to the merger with Ares Capital in 2010. In addition, if the merger with Ares Capital is not approved by our stockholders, a termination fee of \$15 million will be due to Ares Capital.

Impairment of Long-Lived Asset. In our efforts to reduce overall administrative expenses, we sold our corporate aircraft during 2009. The sales price of the aircraft was less than our carrying cost, therefore, we recorded an impairment charge of \$2.9 million during the quarter ended March 31, 2009.

Income Tax Expense, Including Excise Tax. Income tax expense for the years ended December 31, 2009, 2008, and 2007, was as follows:

(\$ in millions)	2009	2008	2007
Income tax expense (benefit)	\$ 5.6	\$ 3.1	\$ (2.7)
Excise tax expense (benefit) ⁽¹⁾		(0.6)	16.3
Income tax expense, including excise tax	\$ 5.6	\$ 2.5	\$ 13.6

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

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

As of December 31, 2009 we estimate we have no dividend distribution requirements for the 2009 tax year, therefore, we have not recorded an excise tax for the year ended December 31, 2009.

Realized Gains and Losses. Net realized gains or losses primarily result from the sale of equity securities associated with certain private finance investments and the realization of unamortized discount resulting from the sale and early repayment of private finance loans and commercial mortgage loans, offset by losses on investments. Net realized gains (losses) for the years ended December 31, 2009, 2008, and 2007, were as follows:

(\$ in millions)	2009	2008	2007
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Realized gains	\$ 52.7	\$ 150.5	\$ 400.5
Realized losses	(413.8)	(279.9)	(132.0)
Net realized gains (losses)	\$ (361.1)	\$ (129.4)	\$ 268.5

When we exit an investment and realize a gain or loss, we make an accounting entry to reverse any unrealized appreciation or depreciation, respectively, we had previously recorded to reflect the appreciated or

depreciated value of the investment. For the years ended December 31, 2009, 2008, and 2007, we reversed previously recorded unrealized appreciation or depreciation when gains or losses were realized as follows:

(\$ in millions)	2009	2008	2007
Reversal of previously recorded net unrealized appreciation associated with realized gains	\$ (28.4)	\$ (119.6)	\$ (332.6)
Reversal of previously recorded net unrealized appreciation associated with dividends received	(10.8)	(11.5)	(1.1)
Reversal of previously recorded net unrealized depreciation associated with realized losses	367.1	249.9	140.9
Total reversal	\$ 327.9	\$ 118.8	\$ (192.8)

Realized gains for the years ended December 31, 2009, 2008, and 2007, were as follows:

(\$ in millions)

Portfolio Company	2009	Amount
Private Finance		
CK Franchising, Inc.		\$ 13.6
Advantage Sales & Marketing, Inc.		6.9
GC-Sun Holdings, LP		6.9
Senior Secured Loan Fund, LLC		6.2
Progressive International Corporation		5.5
Norwesco, Inc.		3.2
Avborne, Inc.		1.9
Allied Capital Senior Debt Fund, L.P.		1.2
Other		3.1
Total private finance		48.5
Commercial Real Estate		
Real Estate Owned		4.1
Other		