ALLIED CAPITAL CORP
Form 497
November 06, 2003

Prospectus Supplement
(To Prospectus dated June 11, 2003)

Filed Pursuant to Rule 497
Registration Statement No. 333-104149

2,600,000 Shares

COMMON STOCK

We are offering for sale 2,600,000 shares of our common stock. Our common stock is traded on the New York Stock Exchange under the symbol ALD. The last reported sales price for our common stock on November 5, 2003 was $24.86 per share.

You should review the information, including the risk of leverage, set forth under Risk Factors on page 9 of the accompanying prospectus before investing in our common stock.

	Per Share	Total
Public offering price	$24.74	$64,324,000
Underwriting discount	$ 0.99	$ 2,574,000
Proceeds to Allied Capital Corporation(1)	$23.75	$61,750,000

(1) Before deducting expenses payable by us estimated to be $50,000.

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

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

The shares of common stock will be ready for delivery on or about November 10, 2003.

JEFFERIES & COMPANY, INC.

The date of this prospectus supplement is November 5, 2003.

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

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Prospectus Supplement

Prospectus

(i)

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

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

FEES AND EXPENSES

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

Shareholders Transaction Expenses	
Sales load (as a percentage of offering price)(1)	4.0%
Dividend reinvestment plan fees(2)	None
Annual Expenses (as a percentage of consolidated net assets attributable to common shares)(3)	
Operating expenses(4)	3.7%
Interest payments on borrowed funds(5)	4.7%
Total annual expenses(6)	8.4%

(1) Represents the underwriting discounts and commissions with respect to the shares sold by Allied Capital in this offering.

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

(3) Consolidated net assets attributable to common stock equals net assets (*i.e.*, total consolidated assets less total consolidated liabilities and preferred stock) at June 30, 2003.

(4) Operating expenses represent our estimated operating expenses for the year ending December 31, 2003, excluding interest on indebtedness. This percentage for the year ended December 31, 2002, was 3.5%.

(5) The Interest payments on borrowed funds represents our estimated interest expenses for the year ending December 31, 2003. We had outstanding borrowings of $979.7 million at June 30, 2003. This percentage for the year ended December 31, 2002, was 4.6%. See Risk Factors in the accompanying prospectus.

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

Example

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

	1 Year	3 Years	5 Years	10 Years
You would pay the following expenses on a $1,000 investment, assuming a 5.0% annual return	$122	$285	$449	$861

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

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

USE OF PROCEEDS

The net proceeds from the sale of the shares of our common stock, after deducting estimated expenses of this offering, are estimated to be $61.7 million. We intend to use the net proceeds from selling our common stock for investment in the debt or equity securities of private companies, non-investment grade commercial mortgage-backed securities or collateralized debt obligation bonds and preferred shares and other general corporate purposes. We may also repay a portion of our revolving line of credit. At November 4, 2003, the interest rate on our revolving line of credit was 2.5% and there were no amounts then outstanding. This revolving line of credit terminates in April 2005 and may be extended under substantially similar terms for one additional year at our option.

UNDERWRITING

Subject to the terms and conditions stated in the underwriting agreement with Jefferies & Company, Inc., the underwriter has agreed to purchase, and we have agreed to sell to the underwriter, all 2,600,000 of the shares offered by this prospectus supplement.

The underwriting agreement provides that the obligations of the underwriter to purchase the shares offered by us are subject to some conditions. The underwriter is obligated to purchase all of the shares offered by us, if any of the shares are purchased.

The underwriter proposes to offer the shares to the public initially at the public offering price set forth on the cover of this prospectus supplement. The public offering price is equal to the volume weighted average price per share of our common stock on the NYSE for each of the 17 trading days beginning on October 14, 2003 and ending on November 5, 2003. After the offering, the public offering price may be changed by the underwriter.

The following table shows the per share and total underwriting discounts and commissions to be paid to the underwriter by us.

Per share	$ 0.99
Total	$2,574,000

We estimate that the total expenses of this offering, excluding the underwriting discounts and commissions, will be approximately $50,000, which will be paid by us.

This offering of the shares is made for delivery when, as and if accepted by the underwriter and subject to prior sale and to withdrawal, cancellation or modification of this offering without notice. The underwriter reserves the right to reject an order for the purchase of shares in whole or in part.

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

We have been advised by the underwriter that, in accordance with Regulation M under the Securities Act, some persons participating in this offering may engage in transactions, including syndicate covering transactions or stabilizing bids, that may have the effect of stabilizing or maintaining the market price of the shares at a level above that which might otherwise prevail in the open market.

A syndicate covering transaction is a bid for or the purchase of shares on behalf of the underwriter to reduce a syndicate short position incurred by the underwriter in connection with this offering. The underwriter may create a syndicate short position by making short sales of our shares and must then purchase our shares in the open market to cover the syndicate short positions created by these short sales. Short sales involve the sale by the underwriter of a greater number of shares than it is required to purchase in this offering. A short position is more likely to be created if the underwriter is concerned that there may be downward pressure in the price of the shares in the open market after pricing that could adversely affect investors who purchase in this offering.

A stabilizing bid is a bid for or the purchase of shares on behalf of the underwriter for the purpose of fixing or maintaining the price of our shares.

We have been advised by the representatives of the underwriter that these transactions may be effected on the NYSE or otherwise and, if commenced, may be discontinued at any time. Similar to other purchase activities, these activities may have the effect of raising or maintaining the market price of our shares or preventing a decline in the market price of our shares. As a result, the price of our shares may be higher than the price that might otherwise exist in the open market.

The underwriter expects to deliver the shares through the facilities of The Depository Trust Company in New York, New York, on or about November 10, 2003. At that time, the underwriter will pay us for the shares in immediately available funds.

This offering is being conducted in compliance with Rule 2810 of the Conduct Rules of the National Association of Securities Dealers, Inc.

The address for Jefferies & Company, Inc. is 520 Madison Avenue, 8th Floor, New York, NY 10022.

LEGAL MATTERS

Certain legal matters with respect to the validity of the shares of common stock we are offering will be passed upon for us by Sutherland Asbill & Brennan LLP, Washington, D.C. Certain legal matters related to the offering will be passed upon for the underwriter by Morgan, Lewis & Bockius LLP, New York, New York.

RECENT DEVELOPMENTS

Operating Results for the Quarter Ended September 30, 2003

For the three months ended September 30, 2003, net investment income was $53.6 million or $0.44 per share, as compared to $45.1 million or $0.44 per share for the three months ended September 30, 2002. Net realized losses were $6.4 million, or $0.05 per share for the quarter ended September 30, 2003, as compared to net realized gains of $48.2 million or $0.47 per share for the quarter ended September 30, 2002. The sum of net investment income and net realized gains or losses was $47.2 million or $0.39 per share for the three months ended September 30, 2003, as compared to $93.3 million or $0.90 per share for the three months ended September 30, 2002.

Net income for the quarter ended September 30, 2003, was $33.7 million or $0.28 per share, after net unrealized depreciation of $13.4 million or $0.11 per share. Net income for the quarter ended September 30, 2002, was $45.5 million or $0.44 per share, after net unrealized depreciation of $47.8 million or $0.46 per share. Net income can vary substantially from quarter to quarter primarily due to changes in unrealized appreciation or depreciation and the recognition of realized gains or losses, which vary from quarter to quarter. As a result, quarterly comparisons of net income may not be meaningful.

During the quarter, we invested a total of $138.4 million. After total repayments of $69.4 million, asset sales of $5.1 million and valuation and other changes during the quarter, total assets were $3.01 billion at September 30, 2003. Shareholders equity increased 15% to $1.78 billion at September 30, 2003, from $1.55 billion at December 31, 2002. Net asset value per share was $14.46 at September 30, 2003.

Portfolio Activity for the Quarter Ended September 30, 2003

New private finance investments totaled $31.7 million and commercial real estate investments totaled $106.7 million for the quarter. At September 30, 2003, the overall weighted average yield on the interest-bearing portfolio was 14.5%, as compared to 14.1% at June 30, 2003.

Private Finance

The private finance portfolio totaled $1.81 billion at September 30, 2003. Loans and debt securities, which totaled $1.16 billion at September 30, 2003, had a weighted average yield of 15.3% as compared to 14.4% at June 30, 2003. Significant new private finance investments during the third quarter of 2003 included:

$6.7 million to Advantage Mayer, Inc., a leading sales and marketing agency specializing in outsourced sales, merchandising, and marketing services to manufacturers, suppliers, and producers of food products and consumer goods, to fund an acquisition;

$5.7 million to Haven Eldercare, LLC, an owner and operator of skilled nursing facilities, to assist the company in gaining control of certain facilities;

$5.0 million to Professional Paint, Inc., a leading manufacturer and distributor of architectural paints and coatings, to finance the company s acquisition of Duckback Products, Inc.;

$3.7 million to Mezzanine Capital Finance, LLC, a company formed to make small real estate mezzanine loans, to help finance additional investments; and

$3.0 million to Foresite Towers, LLC, to fund tower construction and company growth.

Commercial Real Estate Finance

At September 30, 2003, our commercial mortgage-backed securities (CMBS) and collateralized debt obligation bonds and preferred shares (CDO) portfolio totaled $688.4 million, and had a weighted average yield of 13.9% as compared to 14.7% at June 30, 2003. We invested a total of $102.7 million in seven new CMBS transactions during the third quarter of 2003, including $79.0 million of investments in BB+, BB and BB-rated bonds. The yield on the CMBS bond portfolio will fluctuate based on the mix of bond classes. The yield will be lower when the portfolio contains more higher-rated, lower-yielding BB+, BB and BB- rated bonds. The unamortized discount on the CMBS bond portfolio totaled $658.2 million at September 30, 2003.

Portfolio Quality

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

At September 30, 2003, Grade 1 investments totaled $941.8 million, or 36.2% of the total portfolio at value; Grade 2 investments totaled $1.38 billion, or 53.2% of the total portfolio; Grade 3 investments totaled $165.5 million, or 6.4% of the total portfolio; Grade 4 investments totaled $16.2 million, or 0.6% of the total portfolio; and Grade 5 investments totaled $93.8 million, or 3.6% of the total portfolio. Included in Grade 4 and 5 investments are assets totaling $33.3 million that are secured by commercial real estate.

For the total investment portfolio, loans and debt securities greater than 90 days past due were $134.9 million at value at September 30, 2003, or 5.2% of the total portfolio. Included in this category are loans and debt securities valued at $43.0 million that are secured by commercial real estate. Loans and debt securities not accruing interest totaled $118.2 million at September 30, 2003. At September 30, 2003, our CMBS investments included investments in the first loss, unrated bond class of 33 CMBS issuances. For these issuances, loans over 30 days delinquent or classified as real estate owned totaled 1.1% of the total outstanding principal balance of the underlying collateral pool.

Liquidity and Capital Resources

During the quarter ended September 30, 2003, we raised a total of $153.1 million in new equity. We have a revolving line of credit with a committed amount of $462.5 million. The line of credit may be expanded through new or additional commitments up to $600 million, and is a two-year facility with the option to extend the maturity for one additional year under substantially similar terms. At September 30, 2003, there were no amounts drawn on the revolving line of credit. The amount available under the line was $426.6 million, net of amounts committed for standby letters of credit of $35.9 million.

At September 30, 2003, we had a weighted average cost of debt of 7.5%. Our regulatory asset coverage was 306% and the ratio of debt to equity was 0.54 to 1. We are required to maintain regulatory asset coverage of at least 200%.

Quarterly Dividend

On October 17, 2003, we declared a quarterly dividend of $0.57 per share for the fourth quarter of 2003. The dividend is payable on December 26, 2003 to shareholders of record on December 12, 2003.

Our dividend is paid from taxable income. Our board of directors determines the dividend based on annual estimates of taxable income, which differ from book income due to changes in unrealized appreciation and depreciation and due to temporary and permanent differences in income and expense recognition.

Other Matters

In October 2003, we made the following significant new private finance investments:

We provided $16.5 million in subordinated debt to support the buyout of Griffith Energy, Inc. from its parent company, Energy East Corporation. Griffith Energy, Inc. is a distributor of propane, heating oils, and power fuels to residential customers, wholesale customers and independent gasoline dealers in New York.

We purchased $24 million in subordinated debt with warrants of Mercury Air Group, Inc., a company that offers a broad range of services to the aviation industry through its four wholly owned subsidiaries, from a private lender.

Concurrently with our investment in Mercury Air Group, Inc., we also signed a definitive purchase agreement to acquire Mercury Air Centers, Inc., a wholly owned subsidiary of Mercury Air Group, Inc. that provides fixed base operations at 19 airports throughout the United States. The total purchase price is expected to be approximately $70 million in addition to the assumption of construction commitments, subject to certain adjustments. The closing of this transaction is subject to certain conditions, including the satisfactory completion of due diligence by us and the approval of the transaction by the shareholders of Mercury Air Group, Inc. Upon completion of the purchase transaction, Mercury Air Group, Inc. will repay its $24 million subordinated debt obligation to us.

We also recently began to implement certain internal organizational measures that we believe will allow us to grow our business more efficiently, including separating our private finance function into two focused investment areas: mezzanine investing and buyout investing. In addition, our board of directors appointed Scott Binder, one of our managing directors, to the newly created position of Chief Valuation Officer. Other initiatives include increasing our focus on growing our portfolio from within through the dedication of additional time and resources to such matters and building a dedicated resource for assisting portfolio companies in financial transactions, including securing senior debt capital and structured credit transaction.

On September 22, 2003, one of our directors, George C. Williams, retired as a member of our board of directors.

During the second quarter of 2003, our board of directors extended the term of all existing employment agreements with certain of our officers from June 30, 2003 to December 31, 2003.

Summary Financial Information

(in thousands, except per share amounts)	At September 30, 2003 (unaudited)	At December 31, 2002
Assets		
Portfolio at value:		
Private finance	$1,808,708	$1,743,215
Commercial real estate finance	792,350	744,952
Total portfolio at value	2,601,058	2,488,167
Other assets	117,038	100,221
Deposits of proceeds from sales of borrowed Treasury securities	221,732	194,745
Cash and cash equivalents	69,071	11,186
Total assets	$3,008,899	$2,794,319
Liabilities and Shareholders Equity		
Liabilities:		
Debt	$ 954,200	$ 998,450
Obligations to replenish borrowed Treasury securities	221,853	197,027
Mandatorily redeemable preferred stock	1,000	
Accounts payable and other liabilities	50,259	45,771
Total liabilities	1,227,312	1,241,248
Preferred stock	6,000	7,000
Shareholders Equity:		
Common stock	12	11
Additional paid-in-capital	1,854,253	1,547,183
Notes receivable from sale of common stock	(19,502)	(24,704)
Net unrealized appreciation (depreciation) on portfolio	(38,349)	39,411
Undistributed (distributions in excess of) earnings	(20,827)	(15,830)
Total shareholders equity	1,775,587	1,546,071
Total liabilities and shareholders equity	$3,008,899	$2,794,319
Net asset value per common share	$ 14.46	$ 14.22
Common shares outstanding	122,766	108,698

(in thousands, except per share amounts)	3 Months Ended September 30, 2003	3 Months Ended September 30, 2002	9 Months Ended September 30, 2003	9 Months Ended September 30, 2002
	(unaudited)		(unaudited)	
Interest and Related Portfolio Income:				
Interest and dividends	$ 78,895	$ 67,624	$211,553	$195,289
Premiums from loan dispositions	2,523	392	5,281	2,051
Fees and other income	7,452	8,313	22,380	34,573
Total interest and related portfolio income	88,870	76,329	239,214	231,913
Expenses:				
Interest	20,334	17,430	57,614	52,414
Employee	9,480	8,153	26,859	24,462
Administrative	5,897	5,052	15,395	12,913
Total operating expenses	35,711	30,635	99,868	89,789
Net investment income before income taxes	53,159	45,694	139,346	142,124
Income tax expense (benefit)	(449)	600	(1,530)	600
Net investment income	53,608	45,094	140,876	141,524
Net realized and unrealized gains (losses):				
Net realized gains (losses)	(6,438)	48,222	50,441	57,072
Net change in unrealized appreciation or depreciation	(13,426)	(47,796)	(77,760)	(23,661)
Total net gains (losses)	(19,864)	426	(27,319)	33,411
Net increase in net assets resulting from operations	$ 33,744	$ 45,520	$113,557	$174,935
Earnings per common share diluted	$ 0.28	$ 0.44	$ 0.98	$ 1.70
Weighted average common shares outstanding diluted	120,906	103,302	115,228	103,040

INTERIM MANAGEMENT S DISCUSSION AND ANALYSIS

OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following analysis of our financial condition and results of operations should be read in conjunction with our Consolidated Financial Statements and the Notes thereto included herein and in the accompanying prospectus. The information herein 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 in the Risk Factors section in the accompanying prospectus. Other factors that could cause actual results to differ materially include:

the ongoing global economic downturn;

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

future regulatory actions and conditions in our operating areas.

Financial or other information presented for private finance portfolio companies has been obtained from the portfolio company, 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 accounting principles generally accepted in the United States of America 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 accounting principles generally accepted in the United States of America.

OVERVIEW

We are a business development company that provides long-term debt and equity investment capital to companies in a variety of industries. Our lending and investment activity is generally focused on private finance and commercial real estate finance, primarily the investment in non-investment grade commercial mortgage-backed securities, which we refer to as CMBS, and collateralized debt obligation bonds and preferred shares, which we refer to as CDOs. Our private finance activity principally involves providing financing through privately negotiated long-term debt and equity investment capital. Our private financing is generally used to fund growth, buyouts, acquisitions, recapitalizations, note purchases, and bridge financings. We generally invest in private companies though, from time to time, we may invest in public companies that lack access to public capital or whose securities may not be marginable.

Our portfolio composition at June 30, 2003, and December 31, 2002, was as follows:

	2003	2002
Private Finance	72%	70%
Commercial Real Estate Finance	28%	30%

Our earnings depend primarily on the level of interest and dividend income, fee income, and net gains or losses earned on our investment portfolio after deducting interest paid on borrowed capital and operating expenses. Interest income results from the stated interest rate earned on a loan and the amortization of loan origination points and discounts. The level of interest income is directly related to the balance of the interest-bearing investment portfolio multiplied by the weighted average yield. Our ability to generate interest income is dependent on economic, regulatory, and competitive factors that influence new investment activity, 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.

PORTFOLIO AND INVESTMENT ACTIVITY

Total portfolio investment activity and yields at and for the three and six months ended June 30, 2003 and 2002, and at and for the year ended December 31, 2002, were as follows:

($ in millions)	At and for the Three Months Ended June 30,		At and for the Six Months Ended June 30,		At and for the Year Ended December 31,
	2003	2002	2003	2002	2002
	(unaudited)		(unaudited)		
Portfolio at value	$2,546.1	$2,381.0	$2,546.1	$2,381.0	$2,488.2
Investments funded	$ 257.4	$ 115.5	$ 526.4	$ 195.5	$ 506.4
Change in accrued or reinvested interest and dividends	$ 9.3	$ 6.2	$ 20.4	$ 19.5	$ 44.7
Principal repayments	$ 74.3	$ 36.0	$ 150.3	$ 67.0	$ 143.2
Sales	$ 32.6	$ 1.2	$ 276.7	$ 126.3	$ 213.5
Yield[1]	14.1%	13.8%	14.1%	13.8%	14.0%

(1) The weighted average yield on interest-bearing investments is computed as the (a) annual stated interest rate earned plus the annual amortization of loan origination fees, original issue discount, and market discount earned on accruing interest-bearing investments, 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, investment activity, and yields at and for the three and six months ended June 30, 2003 and 2002, and at and for the year ended December 31, 2002, were as follows:

($ in millions)	At and for the Three Months Ended June 30,		At and for the Six Months Ended June 30,		At and for the Year Ended December 31,
	2003	2002	2003	2002	2002
	(unaudited)		(unaudited)		
Portfolio at value:					
Loans and debt securities	$1,192.4	$1,050.8	$1,192.4	$1,050.8	$1,151.2
Equity interests	646.8	584.5	646.8	584.5	592.0
Total portfolio	$1,839.2	$1,635.3	$1,839.2	$1,635.3	$1,743.2
Investments funded	$ 163.8	$ 32.2	$ 273.9	$ 69.8	$ 297.2
Change in accrued or reinvested interest and dividends	$ 8.1	$ 7.0	$ 19.4	$ 19.1	$ 42.6
Principal repayments	$ 70.9	$ 27.2	$ 146.0	$ 56.0	$ 129.3
Yield[1]	14.4%	13.9%	14.4%	13.9%	14.4%

(1) The weighted average yield on loans and debt securities is computed as the (a) annual stated interest rate earned plus the annual amortization of loan origination fees, original issue discount, and market discount earned on accruing loans and debt securities, divided by (b) total loans and debt securities at value. The weighted average yield is computed as of the balance sheet date.

Investments funded for the six months ended June 30, 2003 and 2002, and for the year ended December 31, 2002, consisted of the following:

($ in millions)	Loans and Debt Securities	Equity Interests	Total
For the Six Months Ended June 30, 2003[(1)]			
Companies more than 25% owned	$ 42.2	$25.2	$ 67.4
Companies 5% to 25% owned	9.5	1.0	10.5
Companies less than 5% owned	190.6	5.4	196.0
Total	$242.3	$31.6	$273.9
For the Six Months Ended June 30, 2002[(1)]			
Companies more than 25% owned	$ 16.0	$ 3.8	$ 19.8
Companies 5% to 25% owned	7.5	7.0	14.5
Companies less than 5% owned	34.0	1.5	35.5
Total	$ 57.5	$12.3	$ 69.8
For the Year Ended December 31, 2002[(1)]			
Companies more than 25% owned	$ 86.1	$18.7	$104.8
Companies 5% to 25% owned	22.3	0.4	22.7
Companies less than 5% owned	154.6	15.1	169.7
Total	$263.0	$34.2	$297.2

(1) The private finance portfolio is presented in three categories companies more than 25% owned, which represent portfolio companies where we directly or indirectly own more than 25% of the outstanding voting securities of such portfolio company and, therefore, are deemed controlled by us under the Investment Company Act of 1940, or the 1940 Act; companies owned 5% to 25%, which represent portfolio companies where we directly or indirectly own 5% to 25% of the outstanding voting securities of such portfolio company or where we hold one or more seats on the portfolio company s board of directors and, therefore, are deemed to be an affiliated person under the 1940 Act; and companies less than 5% owned, which represent portfolio companies where we directly or indirectly own less than 5% of the outstanding voting securities of such portfolio company and where we have no other affiliations with such portfolio company.

At June 30, 2003, we had outstanding funding commitments of $103.9 million to portfolio companies, including $27.4 million committed to private venture capital funds. At June 30, 2003, we also had total commitments to portfolio companies in the form of standby letters of credit and guarantees of $96.0 million.

We fund new investments using cash, through the issuance of our common equity, 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 and providing a subsequent investment.

We may acquire more than 50% of the common stock of a company in a control buyout transaction. Control investments are generally structured such that we earn a current return through a combination of interest income on our senior loans and subordinated debt, dividends on our preferred and common stock, and management or transaction services fees to compensate us for the managerial assistance that we provide to a controlled portfolio company. We plan to continue to seek attractive control investments.

Control investments provide the opportunity to invest meaningful amounts of capital with the potential for attractive current income returns as well as the potential for future capital gains. Control transactions are typically larger than our mezzanine investments. In some cases for companies that are more than 50% owned, we may not accrue interest on loans and debt securities if such company is in need of additional working capital. In such cases, we may defer current debt service. Our most significant investments acquired through control buyout transactions at June 30, 2003, were Business Loan Express, LLC (BLX), acquired in 2000, and The Hillman Companies, Inc., acquired in 2001.

Business Loan Express, LLC. At June 30, 2003, our investment in BLX totaled $264.7 million at cost and $356.8 million at value, or 12.6% of our total assets, which includes unrealized appreciation of $92.1 million.

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

During the quarter ended March 31, 2003, BLX completed two significant transactions, the purchase of loans and other assets from Amresco Independence Funding, Inc., or AIF, and the reorganization of BLX from a corporation to a limited liability company, or LLC .

In January 2003, BLX completed the acquisition of $128.0 million of performing loans and other assets from AIF. BLX purchased $121.5 million of performing SBA 7(a) unguaranteed loans at par and $6.5 million of other assets. The acquisition increased BLX s serviced portfolio and enhanced its nationwide loan origination platform. We provided $50 million of the capital to fund this acquisition. Our $50 million financing was in the form of a short-term revolving credit facility of $25 million to fund the temporary capital needs of construction loans purchased and loans pending sale, as well as $25 million of preferred equity to support the future growth potential of BLX post acquisition.

In February 2003, BLX completed a reorganization from a corporation to a limited liability company in order to simplify its corporate structure and provide certain income tax efficiencies. In connection with the reorganization, BLX s stated book equity increased by $43 million because we converted $43 million of our subordinated debt into preferred stock in BLX, Inc., which was exchanged for Class A equity interests in BLX, LLC. In addition, we exchanged our existing preferred stock and common equity investments in BLX, Inc. for similar classes of members equity in BLX, LLC represented by Class B and Class C equity interests, respectively.

Subsequent to the reorganization, BLX s taxable earnings will flow directly to its members and we represent approximately 95% of the economic interests in the LLC. In connection with the reorganization, BLX has changed its fiscal year end to September 30.

Summary financial data for BLX at and for the twelve months ended June 30, 2003 and 2002, is presented below.

($ in millions)	For the Twelve Months Ended June 30, 2003(1)	For the Twelve Months Ended June 30, 2002
Operating Data		
Total revenue	$ 109.1	$ 84.6
Net income(4)	$ 7.5	$ 2.3
Earnings before interest, taxes and management fees (EBITM)(4)	$ 44.4	$ 43.0
Balance Sheet Data		
Total assets(2)	$ 340.0	$ 277.1
Total debt	$ 166.0	$ 183.0
Total owners equity	$ 137.0	$ 59.9
Other Data		
Total loan originations	$ 718.1	$ 565.1
Serviced loan portfolio	$2,165.5	$1,372.6
Number of loans	3,048	2,083
Loan delinquencies(3)	8.1%	9.4%
Serviced Loan Portfolio by Industry		
Hotels	24%	27%
Gas stations/convenience stores	18	16
Professional and retail services	12	10
Restaurants	9	10
Manufacturing and industrial	9	10
Car wash/auto repair services	7	3
Child care and health care services	6	4
Shrimp/fishing vessels	5	7
Recreation	5	5
Other	5	8
Total	100%	100%

(1) Post reorganization BLX s fiscal year end changed to September 30. The results of operations and loan originations for the twelve months ended June 30, 2003, are not necessarily indicative of the operating results to be expected for the fiscal twelve months ending September 30, 2003.

(2) Included in total assets is $6 million of goodwill at June 30, 2003 and 2002. There is no other goodwill on BLX s balance sheet. We acquired 94.9% of BLC Financial Services, Inc. on December 31, 2000. Push-down accounting was not required with respect to this transaction; accordingly, goodwill was not recorded by BLX.

(3) Represents the percentage of loans in the total serviced loan portfolio that are greater than 30 days delinquent, which includes loans in workout status. Loans greater than 30 days delinquent for the SBA 7(a) loan portfolio only, which are included in the total serviced loan portfolio, were 8.2% at June 30, 2003. SBA 7(a) loans greater than one year old at June 30, 2003, had a delinquency rate of 10.5%. BLX will from time to time grant a 90-day deferment to borrowers experiencing short-term cash flow shortfalls. Loans that have been granted a deferment that perform as required are not considered delinquent consistent with SBA practice.

The ability of small businesses to repay their loans may be adversely affected by numerous factors, including a downturn in their industry or negative economic conditions. Small businesses are also more vulnerable to customer preferences, competition, rising fuel prices and market conditions and, as a result, delinquencies in BLX s portfolio may increase. For instance, the shrimp and fishing industry has been affected by rising fuel costs and competition from imported shrimp. For these reasons, BLX focuses on collateral protection for each loan in addition to the cash flow of the small business and receives personal guarantees from the principal owners of the small business.

(4) As an LLC, BLX is generally not subject to a corporate income tax.

For the twelve months ended June 30, 2003, BLX earned revenue of $109.1 million and EBITM of $44.4 million. EBITM was reduced by $2.3 million due to costs associated

with the AIF acquisition and the LLC reorganization, as well as by $1.3 million because of the increased value of issued and outstanding equity appreciation rights to employees. Adding back these acquisition and reorganization costs, and expenses due to equity appreciation rights, BLX s EBITM increased by 11.6% on a comparative twelve month basis. BLX s revenues consist of cash premiums from guaranteed loan sales, gain on sale income arising from loans sold at par or securitized where BLX will receive future cash flows representing the spread between loan interest and the interest paid on bonds issued including service fee income, interest income on loans remaining in BLX s portfolio, and other income. Gain on sale income is a non-cash source of income when recognized, and as future cash flows are received, the resulting cash reduces the receivable or residual interest that is recognized when the loan is sold. The total of cash loan sale premiums, cash interest income and cash received from residual interests and other cash income is equal to approximately 77% of BLX s revenue of $109.1 million during the twelve months ended June 30, 2003.

BLX s business is to originate small business loans and then sell substantially all of the loans originated for cash proceeds. Loans originated during the twelve months ended June 30, 2003, totaled $718.1 million, including loans purchased from AIF. Proceeds from loan sales during the twelve months ended June 30, 2003, totaled approximately $699.4 million. BLX funds the construction of commercial real estate projects, and as a result is unable to sell a construction loan until the loan is fully-funded and the construction is complete. In addition, BLX typically does not immediately receive the proceeds from the sale of its SBA 7(a) guaranteed and unguaranteed loan strips sold, but receives the cash upon settlement. Therefore until BLX sells construction loans or fully funded loans held for sale, it will finance the origination of the loans through funding on its revolving line of credit, or through financing provided by us.

BLX has a three-year $164.0 million revolving credit facility that matures in March 2004. As the controlling equity owner in BLX, we have provided an unconditional guaranty to the revolving credit facility lenders in an amount of up to 50% of the total obligations (consisting of principal, accrued interest, and other fees) of BLX under the revolving credit facility. The amount guaranteed by us at June 30, 2003, was $53.6 million. This guaranty can be called by the lenders only in the event of a default by BLX. BLX was in compliance with the terms of the revolving credit facility at June 30, 2003. We have provided three standby letters of credit in connection with three term securitization transactions completed by BLX totaling $25.6 million.

BLX sells the guaranteed piece of guaranteed loans for cash premiums of up to 10% of the guaranteed loan amount plus a retained annual servicing fee generally between 1.0% and 2.0% of the guaranteed loan amount. Cash premiums received from guaranteed loan sales during the twelve months ended June 30, 2003, were approximately $30.3 million in total.

Alternatively, BLX may sell the guaranteed pieces of SBA 7(a) guaranteed loans at par and receive cash only for the face amount of the loan sold, and instead of receiving a cash premium, BLX will receive an annual servicing spread on the loans sold of between 4.0% and 4.8%. In addition, BLX will sell the unguaranteed pieces of the SBA 7(a) loans and conventional loans it originates into a conduit facility. The conduit loans are securitized and BLX retains an interest of up to 2.7% of the loan pool. BLX then receives the excess of loan interest payments on the loans sold over the interest cost on the securities issued in the securitization over the life of the loan pool. BLX generally receives between 4.3% and 4.9% annually on the loans sold into the securitization pools. For the twelve months ended June 30, 2003, BLX received cash payments from securitization pools of approximately $43.2 million.

When BLX sells a guaranteed piece of an SBA 7(a) loan at par, or when BLX securitizes a loan, it will record a residual interest and servicing asset together referred to as Residual Interest in order to account for the retained interest in the loans sold and the net present value of the future cash flows it will receive from the loans sold or securitized. In computing the Residual Interest, BLX discounts for the present value of future cash flows, and also makes assumptions as to future loan losses and loan prepayments which may reduce future cash flows.

At June 30, 2003, BLX s Residual Interest totaled $162 million, representing BLX s estimate of the net present value of future cash flows of scheduled loan payments, after estimated future loan losses and loan prepayments. If scheduled loan payments were to be received as stated in the loan agreements with no future losses or prepayments, BLX would receive future cash flows of $709 million over time, with approximately $52.3 million, $51.7 million, $50.4 million, and $49.0 million (or $203.4 million in the aggregate) scheduled to be received in the next four years ending on June 30, 2004, 2005, 2006, and 2007, respectively.

The Hillman Companies, Inc. At June 30, 2003, our investment in Hillman totaled $93.6 million at cost and $181.8 million at value, or 6.4% of total assets, which includes unrealized appreciation of $88.2 million.

Hillman is a leading manufacturer of key making equipment and distributor of key blanks, fasteners, signage, and other small hardware components and operates in multiple channels of the retail marketplace such as hardware stores, national and regional home centers, and mass merchants. Hillman has certain patent-protected products including key duplication technology that is important to its business. Hillman s primary operations are located in Cincinnati, Ohio.

For the year ended December 31, 2002, Hillman had total revenue of $286.8 million, earnings before interest, taxes, depreciation, amortization, and management fees, or EBITDAM, of $50.2 million, and profits before taxes of $10.0 million. For the three months ended March 31, 2003, Hillman had total revenue of $70.0 million and EBITDAM of $10.2 million. This EBITDAM is before the write-down of $5.7 million of a note receivable related to an investment made by Hillman. For the three months ended March 31, 2003, Hillman had a loss before taxes of $6.5 million, which includes the write-down of the note receivable. The total revenue, EBITDAM, and loss before taxes for the three months ended March 31, 2003, are not necessarily indicative of the operating results to be expected for the full year. Hillman had total assets of $371.0 million and total debt of $158.6 million at March 31, 2003.

Commercial Real Estate Finance

The commercial real estate finance portfolio, investment activity, and yields at and for the three and six months ended June 30, 2003 and 2002, and at and for the year ended December 31, 2002, were as follows:

	At and for the Three Months Ended June 30,				At and for the Six Months Ended June 30,				At and for the Year Ended December 31, 2002	
	2003		2002		2003		2002			
	(unaudited)				(unaudited)					
($ in millions)	Value	Yield*	Value	Yield*	Value	Yield*	Value	Yield*	Value	Yield*
CMBS bonds	$423.6	13.9%	$560.9	14.6%	$423.6	13.9%	$560.9	14.6%	$555.5	14.2%
CDO bonds and preferred shares	167.4	16.6%	52.5	17.2%	167.4	16.6%	52.5	17.2%	52.8	17.2%
Commercial mortgage loans	105.4	7.8%	62.0	7.9%	105.4	7.8%	62.0	7.9%	63.7	7.5%
Residual interest			69.0	9.3%			69.0	9.3%	69.0	9.4%
Real estate owned	10.5		1.3		10.5		1.3		4.0	
Total portfolio	$706.9		$745.7		$706.9		$745.7		$745.0	
Investments funded	$ 93.6		$ 83.3		$252.5		$125.7		$209.2	
Change in accrued or reinvested interest	$ 1.2		$ (0.8)		$ 1.0		$ 0.4		$ 2.1	
Principal repayments	$ 3.4		$ 8.8		$ 4.3		$ 11.0		$ 13.9	
CMBS, CDO, and commercial real estate loan sales	$ 32.6		$ 1.2		$276.7		$126.3		$213.5	

* The weighted average yield on the interest-bearing investments is computed as the (a) annual stated interest rate earned plus the annual amortization of loan origination fees, original issue discount, and market discount earned on accruing interest-bearing investments, 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.

Our commercial real estate investment activity for the six months ended June 30, 2003 and 2002, and for the year ended December 31, 2002, was as follows:

($ in millions)	Face Amount	Discount	Amount Funded
For the Six Months Ended June 30, 2003			
CMBS bonds	$250.1	$(115.7)	$134.4
CDO bonds and preferred shares	118.4	(0.3)	118.1
Total	$368.5	$(116.0)	$252.5
For the Six Months Ended June 30, 2002			
CMBS bonds	$181.4	$ (83.8)	$ 97.6
CDO preferred shares	28.0		28.0
Commercial mortgage loans	0.1		0.1
Total	$209.5	$ (83.8)	$125.7

For the Year Ended December 31, 2002			
CMBS bonds	$302.5	$(140.2)	$162.3
CDO preferred shares	29.0		29.0
Commercial mortgage loans	11.7	(1.7)	10.0
Real estate owned	7.9		7.9
Total	$351.1	$(141.9)	$209.2

CMBS Bonds. During the six months ended June 30, 2003 and 2002, we invested $134.4 million in seven CMBS bond issuances and $97.6 million in three CMBS bond issuances, respectively. During th