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

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

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 o NO x

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 x NO o

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 o NO o

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. x

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

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

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)	**Assets of Managed Funds December 31,**		**Management**
Name of Fund	**2009**	**2008**	**Fee**
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 s 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)				

Net increase (decrease) in net assets resulting from operations	$	(521,498)	$	(1,040,006)	$	153,303	$	245,123	$	872,814
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 diluted		178,994		172,996		154,687		145,599		137,274

(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)

thousands, cept per share data)	**2009 Qtr 4**	**Qtr 3**	**Qtr 2**	**Qtr 1**	**2008 Qtr 4**	**Qtr 3**	**Qtr 2**	**Qtr 1**
arterly Data naudited):								
tal interest and related rtfolio income	$ 66,436	$ 72,438	$ 84,630	$ 95,182	$ 100,928	$ 120,662	$ 134,578	$ 144,94
t investment income ss)	231	9,585	18,233	27,514	33,043	45,595	63,855	69,54
t increase (decrease) net assets resulting m operations	(4,082)	(140,683)	(29,063)	(347,670)	(578,829)	(318,262)	(102,203)	(40,71
uted earnings (loss) common share	$ (0.02)	$ (0.79)	$ (0.16)	$ (1.95)	$ (3.24)	$ (1.78)	$ (0.59)	$ (0.2
vidends declared per mmon share[(5)]					0.65	0.65	0.65	0.6
t asset value per mmon share[(4)]	6.66	6.70	7.49	7.67	9.62	13.51	15.93	16.9

(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:

	At and for the Years Ended December 31,		
($ in millions)	**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:

	At and for the Years Ended December 31,					
	2009		2008		2007	
($ in millions)	**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:

	2009 Investments Funded					
	Debt Investments		Buyout Investments		Total	
($ in millions)	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	

	2008 Investments Funded					
	Debt Investments		Buyout Investments		Total	
($ in millions)	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					
	Debt Investments		Buyout Investments		Total	
($ in millions)	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	0.7	12.4%			0.7	12.4%
Equity	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 More Than 25% Owned[1]	Companies 5% to 25% Owned	Companies Less Than 5% Owned	Total
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:

	2009			2008		
($ in millions)	**Cost**	**Value**	**Yield[(1)]**	**Cost**	**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:

	2009		2008	
($ in millions)	**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:

	At and for the Years Ended December 31,					
	2009		2008		2007	
($ in millions)	**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, 2009	2008	Management Fee
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)		2009		2008	
Name of Fund	Investment Description	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:

	2009		2008	
($ in millions)	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

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
lated Portfolio Income							
vidends	$ 290,986	$ 457,418	$ (166,432)	(36)%	$ 457,418	$ 417,576	$ 39,84
income	27,700	43,694	(15,994)	(37)%	43,694	44,129	(43
nd related portfolio income	318,686	501,112	(182,426)	(36)%	501,112	461,705	39,40
	171,068	148,930	22,138	15%	148,930	132,080	16,85
	42,104	76,429	(34,325)	(45)%	76,429	89,155	(12,72
k options	3,355	11,781	(8,426)	(72)%	11,781	35,233	(23,45
	38,147	49,424	(11,277)	(23)%	49,424	50,580	(1,15
long-lived asset	2,873		2,873	**			
g expenses	257,547	286,564	(29,017)	(10)%	286,564	307,048	(20,48
t income before income taxes	61,139	214,548	(153,409)	(72)%	214,548	154,657	59,89
pense, including excise tax	5,576	2,506	3,070	123%	2,506	13,624	(11,11
t income	55,563	212,042	(156,479)	(74)%	212,042	141,033	71,00
nd Unrealized Gains (Losses)							
ins (losses)	(361,128)	(129,418)	(231,710)	179%	(129,418)	268,513	(397,93
unrealized appreciation or	(176,689)	(1,123,762)	947,073	*	(1,123,762)	(256,243)	(867,51
(losses)	(537,817)	(1,253,180)	715,363	*	(1,253,180)	12,270	(1,265,45
hase of debt	83,532	1,132	82,400	**	1,132		1,13
uishment of debt	(122,776)		(122,776)	**			
ss)	$ (521,498)	$ (1,040,006)	$ 518,508	(50)%	$ (1,040,006)	$ 153,303	$ (1,193,30
gs per common share	$ (2.91)	$ (6.01)	$ 3.10	(52)%	$ (6.01)	$ 0.99	$ (7.0
age common shares diluted	178,994	172,996	5,998	3%	172,996	154,687	18,30

* 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:

	2009		**2008**		**2007**	
($ in millions)	**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**

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)

2009 **Portfolio Company**	**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	0.1
Total commercial real estate	4.2
Total realized gains	$ 52.7

2008 **Portfolio Company**	**Amount**

Private Finance:		
Norwesco, Inc.	$	104.9
BI Incorporated		7.9
BenefitMall, Inc.		4.9
Mercury Air Centers, Inc.		6.0
Advantage Sales and Marketing, Inc[(1)].		3.4
Financial Pacific Company		3.1
Passport Health Communications, Inc.		1.8
Service Champ, Inc.		1.7
HMT, Inc.		1.6
Coverall North America, Inc.		1.4
Penn Detroit Diesel Allison, LLC		1.4
Avborne Heavy Maintenance		1.2
MedAssets, Inc.		1.3
Legacy Partners Group, Inc.		1.3
Other		8.2
Total Private Finance		150.1
Commercial Real Estate:		
Other		0.4
Total Commercial Real Estate		0.4
Total realized gains	$	150.5

2007

Portfolio Company		Amount
Private Finance:		
Mercury Air Centers, Inc.	$	262.4
HMT, Inc.		39.9
Healthy Pet Corp.		36.6
Palm Coast Data, LLC		20.0
Woodstream Corporation		14.6
Wear Me Apparel Corporation		6.1
Mogas Energy, LLC		5.7
Tradesmen International, Inc.		3.8
ForeSite Towers, LLC		3.8
Advantage Sales & Marketing, Inc.		3.4
Geotrace Technologies, Inc.		1.1
Other		3.0
Total private finance		400.4
Commercial Real Estate:		
Other		0.1
Total commercial real estate		0.1

Total realized gains	$	400.5

(1) Includes an additional realized gain of $1.9 million related to the release of escrowed funds from the sale of our majority equity investment in 2006.

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

($ in millions)

2009		
Portfolio Company		**Amount**
Private Finance		
WMA Equity Corporation and Affiliates	$	103.0
MHF Logistical Solutions, Inc.		70.7
CR Holding, Inc.		62.6
Advantage Sales & Marketing, Inc.(1)		29.8
TransAmerican Auto Parts, LLC		26.2
Triax Holdings, LLC		22.7
Worldwide Express Operations, LLC		13.0
Higginbotham Insurance Agency, Inc.		11.4
FCP-BHI Holdings, LLC		8.2
Augusta Sportswear Group, Inc.		7.2
Calder Capital Partners, LLC		6.1
The Hillman Companies, Inc.		5.7
Broadcast Electronics, Inc.		4.5
Old Orchard Brands, LLC		4.3
Tank Intermediate Holding Corp.		4.2
Abraxas Corporation		3.5
Pro Mach, Inc.		2.9
Becker Underwood, Inc.		2.8
The Homax Group, Inc.		2.5
Baird Capital Partners IV Limited		2.0
Penn Detroit Diesel Allison, LLC		1.7
Snow Phipps Group, L.P.		1.6
Other		9.3
Total private finance		405.9
Commercial Real Estate		
Real Estate Owned		7.9
Other		
Total commercial real estate		7.9
Total realized losses	$	413.8

2008		
Portfolio Company		**Amount**
Private Finance:		
Ciena Capital LLC	$	98.9

Alaris Consulting, LLC		36.0
Pendum, Inc.		34.0
Line-X, Inc.		23.3
Creative Group, Inc.		15.6
Driven Brands, Inc.		10.8
Triview Investments, Inc.		8.6
MedBridge Healthcare LLC		7.6
Garden Ridge Corporation		5.4
Mid-Atlantic Venture Fund IV, L.P.		5.2
WMA Equity Corporation (and Affiliates)		4.5
Legacy Partners Group, Inc.		4.3
Direct Capital Corporation		1.7
EarthColor, Inc.		1.7
Crescent Equity Corp. Longview Cable & Data, LLC		1.6
Summit Energy Services, Inc.		1.6
Sweet Traditions, Inc.		1.6
Walker Investment Fund II, LLLP		1.4
United Road Towing		1.3
Other		10.2
Total Private Finance		275.3
Commercial Real Estate:		
Other		4.6
Total commercial real estate		4.6
Total realized losses	$	279.9

2007		
Portfolio Company		**Amount**
Private Finance:		
Global Communications, LLC	$	34.3
Jakel, Inc.		24.8
Startec Global Communications, Inc.		20.2
Gordian Group, Inc.		19.3
Powell Plant Farms, Inc.		11.6
Universal Environmental Services, LLC		8.6
PresAir, LLC		6.0
Legacy Partners Group, LLC		5.8
Alaris Consulting, LLC		1.0
Other		0.4
Total realized losses	$	132.0

(1) Realized loss relates to the sale of our escrow receivable, which was included in other assets on the balance sheet.

During the year ended December 31, 2009, we focused our efforts on selectively selling assets from our portfolio in order to generate capital to repay indebtedness and de-lever our balance sheet. These asset sales have been completed under distressed conditions in a very difficult market, and consequently we have realized net losses upon their disposition. For the year ended December 31, 2009, had principal repayments on portfolio investments that generated cash proceeds of $1,069.7 million.

Realized gains and losses for the year ended December 31, 2009 and 2008, included net realized gains totaling $6.3 million and $8.3 million (subsequent to post-closing adjustments) from the sale of certain investments to Managed Funds. In addition, realized losses for the year ended December 31, 2008, include $7.0 million (subsequent to post-closing adjustments) related to the sale of certain venture capital and private equity limited partnership investments to a fund managed by Goldman Sachs. For the year ended December 31, 2008, net realized losses also include net realized losses totaling $7.3 million resulting from the sale of loans and debt securities totaling $216.3 million to the Allied Capital Senior Debt Fund, L.P., Knightsbridge CLO 2007-1 Ltd. and Knightsbridge CLO 2008-1 Ltd. For the year ended December 31, 2007, net realized gains also include net realized gains totaling $1.0 million resulting from the sale of loans and debt securities totaling $224.2 million to the Allied Capital Senior Debt Fund, L.P. See Managed Funds above.

Change in Unrealized Appreciation or Depreciation. We determine the value of each investment in our portfolio on a quarterly basis, and changes in value result in unrealized appreciation or depreciation being recognized in our statement of operations. Value, as defined in Section 2(a)(41) of the Investment Company Act of 1940, is (i) the market price for those securities for which a market quotation is readily available and (ii) for all other securities and assets, fair value is as determined in good faith by the Board of Directors. Since there is typically no readily available market value for the investments in our portfolio, we value substantially all of our portfolio investments at fair value as determined in good faith by the Board of Directors in accordance with our valuation policy and the provisions of the 1940 Act and 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.

As a BDC, we invest in illiquid securities including debt and equity securities of portfolio companies, CLO bonds and preferred shares/income notes, CDO bonds and investment funds. The structure of each debt and equity security is specifically negotiated to enable us to protect our investment and maximize our returns. We include many terms governing interest rate, repayment terms, prepayment penalties, financial covenants, operating covenants, ownership parameters, dilution parameters, liquidation preferences, voting rights, and put or call rights. Our investments may be subject to certain restrictions on resale and generally have no established trading market.

Because of the type of investments that we make and the nature of our business, our valuation process requires an analysis of various factors. Our fair value methodology includes the examination of, among other things, the underlying investment performance, financial condition, and market changing events that impact valuation.

Valuation Methodology. We adopted the standards in ASC Topic 820 on a prospective basis in the first quarter of 2008. These standards require us to assume that the portfolio investment is to be sold in the principal market to market participants, or in the absence of a principal market, the most advantageous market, which may be a hypothetical market. Market participants are defined as buyers and sellers in the principal or most advantageous market that are independent, knowledgeable, and willing and able to transact. In accordance with the standards, we have considered our principal market, or the market in which we exit our portfolio investments with the greatest volume and level of activity.

We have determined that for our buyout investments, where we have control or could gain control through an option or warrant security, both the debt and equity securities of the portfolio investment would exit in the merger and acquisition (M&A) market as the principal market generally through a sale or recapitalization of the portfolio company. We believe that the in-use premise of value (as defined in ASC Topic 820), which assumes the debt and equity securities are sold together, is appropriate as this would provide maximum proceeds to the seller. As a result, we use the enterprise value methodology to determine the fair value of these investments. Enterprise value means the entire value of the company to a market participant, including the sum of the values of debt and equity securities used to capitalize the enterprise at a point in time. Enterprise value is determined using various factors, including cash flow from operations of the portfolio company, multiples at which private companies are bought and sold, and other pertinent factors, such as recent offers to purchase a portfolio company, recent transactions involving the purchase or sale of the portfolio company s equity securities, liquidation events, or other events. We allocate the enterprise value to these securities in order of the legal priority of the securities.

There is no one methodology to determine enterprise value and, in fact, for any one portfolio company, enterprise value is best expressed as a range of fair values. However, we must derive a single estimate of enterprise value. To determine the enterprise value of a portfolio company, we analyze its historical and projected financial results. This financial and other information is generally obtained from the portfolio companies, and may represent unaudited, projected or pro forma financial information. We generally require portfolio companies to provide annual audited and quarterly unaudited financial statements, as well as annual projections for the upcoming fiscal year. Typically in the private equity business, companies are bought and sold based on multiples of EBITDA, cash flow, net income, revenues or, in limited instances, book value. The private equity industry uses financial measures such as EBITDA or EBITDAM (Earnings Before Interest, Taxes, Depreciation, Amortization and, in some instances, Management fees) in order to assess a portfolio company s financial performance and to value a portfolio company. EBITDA and EBITDAM are not intended to represent cash flow from operations as defined by U.S. generally accepted accounting principles and such information should not be considered as an alternative to net income, cash flow from operations, or any other measure of performance prescribed by U.S. generally accepted accounting principles. When using EBITDA to determine enterprise value, we may adjust EBITDA for non-recurring items. Such adjustments are intended to normalize EBITDA to reflect the portfolio company s earnings power. Adjustments to EBITDA may include compensation to previous owners, acquisition, recapitalization, or restructuring related items or one-time non-recurring income or expense items.

In determining a multiple to use for valuation purposes, we generally look to private merger and acquisition statistics, the entry multiple for the transaction, discounted public trading multiples or industry practices. In estimating a reasonable multiple, we consider not only the fact that our portfolio company may be a private company relative to a peer group of public comparables, but we also consider the size and scope of our portfolio company and its specific strengths and weaknesses. In some cases, the best valuation methodology may be a discounted cash flow analysis based on future projections. If a portfolio company is distressed, a liquidation analysis may provide the best indication of enterprise value.

While we typically exit our securities upon the sale or recapitalization of the portfolio company in the M&A market, for investments in portfolio companies where we do not have control or the ability to gain control through an option or warrant security, we cannot typically control the exit of our investment into our principal market (the M&A market). As a result, in accordance with ASC Topic 820, we are required to determine the fair value of these investments assuming a sale of the individual investment (the in-exchange premise of value) in a hypothetical market to a hypothetical market participant. We continue to perform an enterprise value analysis for investments in this category to assess the credit risk of the loan or debt security and to determine the fair value of our equity investment in these portfolio companies. The determined equity values are generally discounted when we have a minority ownership position, restrictions on resale, specific concerns about the receptivity of the capital markets to a specific company at a certain time, or other factors. For loan and debt securities, we perform a yield analysis assuming a hypothetical current sale of the investment. The yield analysis requires us to estimate the expected repayment date of the instrument and a market participant s required yield. Our estimate of the expected repayment date of a loan or debt security may be shorter than the legal maturity of the instruments as our loans historically have been repaid prior to the maturity date. The yield analysis considers changes in interest rates and changes in leverage levels of the loan or debt security as compared to market interest rates and leverage levels. Assuming the credit quality of the loan or debt security remains stable, we will use the value determined by the yield analysis as the fair value for that security. A change in the assumptions that we use to estimate the fair value of our loans and debt securities using a yield analysis could have a material impact on the determination of fair value. If there is deterioration in credit quality or a loan or debt security is in workout status, we may consider other factors in determining the fair value of a loan or debt security, including the value attributable to the loan or debt security from the enterprise value of the portfolio company or the proceeds that would be received in a liquidation analysis.

Our equity investments in private debt and equity funds are generally valued based on the amount that we believe would be received if the investments were sold and consider the fund s net asset value, observable transactions and other factors. The value of our equity securities in public companies for which quoted prices in an active market are readily available is based on the closing public market price on the measurement date.

The fair value of our CLO/CDO Assets is generally based on a discounted cash flow model that utilizes prepayment, re-investment, loss and ratings assumptions based on historical experience and projected performance, economic factors, the characteristics of the underlying cash flow and comparable yields for similar bonds and preferred shares/income notes, when available. We recognize unrealized appreciation or depreciation on our CLO/CDO Assets as comparable yields in the market change and/or based on changes in estimated cash flows resulting from changes in prepayment, re-investment, loss or ratings assumptions in the underlying collateral pool, or changes in redemption assumptions for the CLO/CDO Assets, if applicable. We determine the fair value of our CLO/CDO Assets on an individual security-by-security basis. If we were to sell a group of these CLO/CDO Assets in a pool in one or more transactions, the total value received for that pool may be different than the sum of the fair values of the individual assets.

We record unrealized depreciation on investments when we determine that the fair value of a security is less than its cost basis, and record unrealized appreciation when we determine that the fair value is greater than its cost basis. Because of the inherent uncertainty of valuation, the values determined at the measurement date 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. Additionally, changes in the market environment and other events that may occur over the life of the investments may cause the gains or losses ultimately realized on these investments to be different than the values determined at the measurement date. ASC Topic 820 also includes the codification of *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have*

Significantly Decreased and Identifying Transactions That Are Not Orderly (FSP 157-4), which was issued by the FASB in April 2009. These provisions provide guidance on how to determine the fair value of assets under ASC Topic 820 in the current economic environment and reemphasize that the objective of a fair value measurement remains an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. These provisions state that a transaction price that is associated with a transaction that is not orderly is not determinative of fair value or market-participant risk premiums and companies should place little, if any, weight (compared with other indications of fair value) on transactions that are not orderly when estimating fair value or market risk premiums.

As a participant in the private equity business, we primarily invest in private middle market companies for which there is generally no publicly available information. Because of the private nature of these businesses, there is a need to maintain the confidentiality of the financial and other information that we have for the private companies in our portfolio. We believe that maintaining this confidence is important, as disclosure of such information could disadvantage our portfolio companies and could put us at a disadvantage in attracting new investments. Therefore, we do not intend to disclose financial or other information about our portfolio companies, unless required, because we believe doing so may put them at an economic or competitive disadvantage, regardless of our level of ownership or control.

We work with third-party consultants to obtain assistance in determining fair value for a portion of the private finance portfolio each quarter. We work with these consultants to obtain assistance as additional support in the preparation of our internal valuation analysis. In addition, we may receive third-party assessments of a particular private finance portfolio company s value in the ordinary course of business, most often in the context of a prospective sale transaction or in the context of a bankruptcy process.

The valuation analysis prepared by management 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. For the years ended December 31, 2009, 2008, and 2007, we received third-party valuation assistance as follows:

	2009			
	Q4	**Q3**	**Q2**	**Q1**
Number of private finance portfolio companies reviewed	59	78	91	93
Percentage of private finance portfolio reviewed at value	94.6%	97.8%	96.9%	94.0%

	2008			
	Q4	**Q3**	**Q2**	**Q1**
Number of private finance portfolio companies reviewed	86	128	119	124
Percentage of private finance portfolio reviewed at value	89.8%	97.2%	94.9%	94.0%

2007

	Q4	Q3	Q2	Q1
Number of private finance portfolio companies reviewed	112	135	92	88
Percentage of private finance portfolio reviewed at value	91.1%	92.1%	92.1%	91.8%

Professional fees for third-party valuation assistance for the years ended December 31, 2009, 2008, and 2007, were $1.1 million, $1.9 million, and $1.8 million, respectively.

Net Change in Unrealized Appreciation or Depreciation. Net change in unrealized appreciation or depreciation for the years ended December 31, 2009, 2008, and 2007, consisted of the following:

($ in millions)	**2009[1]**	**2008[1]**	**2007[1]**
Net unrealized appreciation (depreciation)[2]	$ (504.6)	$ (1,242.6)	$ (63.4)
Reversal of previously recorded 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 unrealized depreciation associated with realized losses	367.1	249.9	140.9
Net change in unrealized appreciation or depreciation	$ (176.7)	$ (1,123.8)	$ (256.2)

(1) The net change in unrealized appreciation or depreciation can fluctuate significantly from year to year. As a result, annual comparisons may not be meaningful.

(2) The sale of certain of our portfolio investments to AGILE Fund I, LLC that occurred in the first quarter of 2008 provided transaction values for 59 portfolio investments that were used in the December 31, 2007, valuation process.

The primary drivers of the net unrealized depreciation of $504.6 million related to changes in portfolio value for the year ended December 31, 2009, were (i) depreciation in our financial services and asset management portfolio companies (excluding our investment in Ciena) and our CLO/CDO investments, which totaled $179.5 million, (ii) additional depreciation of $102.0 million related to our investment in Ciena resulting from the decline in value of their residual interest assets and other financial assets as discussed below, (iii) additional depreciation of $77.2 million on our investment in EarthColor, Inc., a full service commercial printer, and (iv) decreased enterprise values as a result of the decline in market benchmarks and, in some cases, lower EBITDA generally driven by current economic conditions.

In the current economic environment, the values of financial assets have declined significantly and it is difficult to predict when the values for financial assets will cease to decrease in value. As a result, we may continue to experience further net unrealized depreciation in our portfolio due to declining asset values. In addition, we may continue to experience further net unrealized depreciation in our portfolio due to declining values or due to decreased operating performance of our portfolio companies in this difficult economy. Also we may choose to sell assets for proceeds totaling less than fair value in order to generate capital to repay debt.

Valuation of Ciena Capital LLC. Our investment in Ciena totaled $547.6 million at cost and $100.1 million at value, which included unrealized depreciation of $447.5 million, at December 31, 2009, and $547.8 million at cost and $104.9 million at value, which included unrealized depreciation of $442.9 million, at December 31, 2008. 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. To value our investment at December 31, 2009 and 2008, we considered the effect of Ciena s voluntary filing for bankruptcy protection. See Private Finance, Ciena Capital LLC above.

Ciena s origination platform has been discontinued, and we continue to attribute no value to Ciena s enterprise due to the state of the securitization markets, among other factors. We valued our investment in Ciena at December 31, 2009, solely based on the estimated net realizable value of Ciena s assets, including the estimated net realizable value of the cash flows generated from Ciena s retained interests in its current servicing portfolio, which includes portfolio servicing fees as well as cash flows from Ciena s equity investments in its securitizations and its interest only strip. The decrease in value primarily is a result of the continued decline in the fair value of the assets supporting Ciena s retained interests and assets held on Ciena s balance sheet. This decrease primarily is a result of an increase in borrower defaults in the current economic environment and decreasing values for assets. We also continued to consider Ciena s current regulatory issues and ongoing investigations and litigation in performing the valuation analysis at December 31, 2009. See Private Finance, Ciena Capital LLC above.

We received valuation assistance from Duff & Phelps for our investment in Ciena at December 31, 2009, 2008, and 2007. See Valuation Methodology Private Finance above for further discussion of the third-party valuation assistance we received.

Gain on Repurchase of Debt. During the year ended December 31, 2009, we purchased publicly issued notes in the market with a total par value of $134.5 million, which consisted of $80.1 million of our 6.625% Notes due 2011 and $54.4 million of our 6.000% Notes due 2012, for a total cost of $50.3 million. After recognizing the remaining unamortized original issue discount associated with the notes repurchased, we recognized a net gain on repurchase of debt of $83.5 million for the year ended December 31, 2009.

Loss on Extinguishment of Debt. In connection with the restructuring of our privately issued notes and bank facility that was completed in August 2009, we recorded a loss on the extinguishment of debt of $117.5 million. In addition to the $11 million of previously deferred unamortized debt costs associated with the Notes and Facility, we incurred and paid costs to the lenders of $146 million and other third party advisory and other fees of approximately $26 million in connection with the restructuring. Approximately $20 million of the restructuring costs were deferred and are being amortized into interest expense over the life of the Notes and Facility. After completion of the restructure, we recorded approximately $45 million of original issue discount (OID) related to the restructuring of the Notes, which is being amortized into interest expense over the life of the Notes. After completion of the restructure, we recorded an additional $5.3 million of loss on extinguishment of debt in connection with the prepayment of certain of our private notes in 2009.

Per Share Amounts. All per share amounts included in the Management s Discussion and Analysis of Financial Condition and Results of Operations section have been computed using the weighted average common shares used to compute diluted earnings per share, which were 179.0 million, 173.0 million and 154.7 million, for the years ended December 31, 2009, 2008, and 2007, respectively.

OTHER MATTERS

Regulated Investment Company Status. We have elected to be taxed as a regulated investment company under Subchapter M of the Code. In order to maintain our status as a regulated investment company and obtain regulated investment company tax benefits, we must, in general, (1) continue to qualify as a business development company; (2) derive at least 90% of our gross income from dividends, interest, gains from the sale of securities and other specified types of income; (3) meet asset diversification requirements as defined in the Code; and (4) timely distribute to shareholders at least 90% of our annual investment company taxable income (i.e., net ordinary investment income) as defined in the Code. With respect to taxable realized net long-term capital gains, we may choose to (i) distribute, (ii) deem to distribute, or (iii) retain and pay corporate level tax on such gains. We currently qualify as a regulated investment company. However, there can be no assurance that we will continue to qualify for such treatment in future years.

As long as we qualify as a regulated investment company, we are not taxed on our investment company taxable income or realized net capital gains, to the extent that such taxable income or gains are distributed, or deemed to be distributed, to shareholders on a timely basis. Taxable income includes our taxable interest, dividend and fee income, as well as taxable net capital gains. Taxable income generally differs from net income for financial reporting purposes due to temporary and permanent differences in the recognition of income and expenses, and generally excludes net unrealized appreciation or depreciation, as gains or losses are not included in taxable income until they are realized. 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 (see discussion below). 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.

DIVIDENDS AND DISTRIBUTIONS

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 shareholders through the payment of dividends. In certain circumstances, we are restricted in our ability to pay dividends. Our Term Loan contains provisions limiting 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 continue to retain capital in 2010 and 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 RIC, however there can be no assurance that we will be able to comply with the RIC requirements to distribute income for 2010 and other future years and we may be required to pay a corporate level income tax.

We did not pay any dividends to common shareholders during 2009. Total dividends to common shareholders were $2.60, and $2.57, per common share for the years ended December 31, 2008, and 2007, respectively. An extra cash dividend of $0.07 and $0.05, per common share was declared during each of 2007 and 2006, and was paid to shareholders on December 27, 2007 and January 19, 2007, respectively.

No distribution was declared or paid in 2009. We currently estimate a net taxable loss for 2009, and, therefore, we believe we have no distribution requirement for 2009. The summary of our taxable income and distributions of such taxable income for the years ended December 31, 2008, and 2007, is as follows:

($ in millions)	**2008**	**2007**
Taxable income[(1)]	$ 40.4	$ 397.8
Taxable income earned in prior year and carried forward and distributed in current year	393.3	402.8
Taxable income earned in current year and carried forward for distribution in next year		(393.3)
Distributions from accumulated earnings	22.8	
Total dividends to common shareholders	$ 456.5	$ 407.3

(1) See Note 10, Dividends and Distributions and Taxes of our Notes to Consolidated Financial Statements included in Item 8 for further information on the differences between net income for book purposes and taxable income.

We currently estimate that we have cumulative deferred taxable income related to installment sale gains of approximately $44.4 million as of December 31, 2009. These gains have been recognized for financial reporting purposes in the respective years they were realized, but will be deferred for tax purposes until the notes or other amounts received from the sale of the related investments are collected in cash. These installment sale gains as of December 31, 2009 are estimates and will not be determined finally until we file our 2009 tax return in September 2010. See Other Matters Regulated Investment Company Status above.

To the extent that installment sale gains are deferred for recognition in taxable income, we pay interest to the Internal Revenue Service. Installment-related interest expense for the years ended December 31, 2009, 2008, and 2007, was $6.3 million, $7.7 million, and $5.8 million, respectively. This interest is included in interest expense in our Consolidated Statement of Operations.

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

At December 31, 2009 and 2008, our cash and investments in money market and other securities, total assets, total debt outstanding, total shareholders equity, debt to equity ratio and asset coverage for senior indebtedness were as follows:

($ in millions)	**2009**	**2008**
Cash and investments in money market and other securities (including money market and other securities: 2009-$381.0, 2008-$0.3)	$ 401.7	$ 50.7
Total assets	$ 2,665.5	$ 3,722.2
Total debt outstanding	$ 1,426.0(2)	$ 1,945.0
Total shareholders equity	$ 1,198.2	$ 1,718.4
Debt to equity ratio	1.19	1.13
Asset coverage ratio[(1)]	180%	188%

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

(2) The notes payable on the consolidated balance sheet are shown net of OID of approximately $33.8 million as of December 31, 2009.

At December 31, 2009, our asset coverage ratio was 180%, and we remained precluded under the 1940 Act from incurring additional indebtedness, declaring dividends or other distributions to our shareholders, or repurchasing shares of our common stock until such time as our asset coverage would be at least 200%. In addition, we generally are not able to issue and sell our common stock at a price below net asset value per share without the approval of our stockholders. Our common stock currently is trading at a price below our net asset value of $6.66 per share.

We have engaged and may continue to engage in a variety of activities as a means to improve our asset coverage ratio and net asset value, which may include but are not limited to: continuing to sell assets to generate capital to retire debt; refinancing or repurchasing, at par or at a discount, our outstanding debt; and foregoing or limiting dividend payments in order to retain capital. We also plan to continue to carefully manage our employee and administrative expenses. There can be no assurance that we will be able to increase our asset coverage ratio or net asset value.

During the year ended December 31, 2009, we sold or had repayments on portfolio investments that generated $1,069.7 million of cash proceeds. These asset sales have been completed under distressed conditions in a very difficult market and consequently we have realized net losses upon their disposition (see Realized Gains and Losses above). We expect to complete additional asset sales during 2010 and given the challenging market and our desire to sell assets to generate liquidity, we may incur additional realized losses upon such dispositions. We expect that the cash generated from asset sales and repayments will be used to repay indebtedness and provide ongoing liquidity. We believe that we will generate sufficient cash flow to fund our operations and meet our scheduled debt service requirements, although there can be no assurance that we will generate sufficient cash flow.

We had total debt outstanding at par of $1.5 billion at December 31, 2009, as compared to $1.9 billion at December 31, 2008, a $485.2 million reduction in debt outstanding. During the year ended December 31, 2009, we paid $30.1 million to repurchase certain of the 6.625% Notes due 2011 which had a face value of $80.1 million, and $20.2 million to repurchase certain of the 6.000% Notes due 2012 which had a face value of $54.4 million. In addition, we repaid $350.7 million on our privately issued notes and bank facility during 2009.

From December 31, 2009 through January 29, 2010, we collected additional cash proceeds from asset sales totaling approximately $150 million of which $119 million was from sales to Ares Capital or an affiliate of Ares Capital. In addition, on January 29, 2010, we repaid in full our privately issued notes and our bank facility through cash generated by asset sales and repayments and refinancing proceeds from a new $250 million secured term loan. See Debt Refinance. On January 29, 2010, after giving effect to the refinancing and the full repayment of the private debt, we had total outstanding debt of $995.5 million and cash and investments in money market and other securities of approximately $128 million. This refinancing and the related payoff of the existing secured private debt allowed us to return to an asset coverage ratio above 200%, assuming no changes in portfolio values since December 31, 2009. Upon the completion of the refinancing and the related payoff of the existing secured private debt, we had no outstanding debt maturing in 2010 and $570 million of outstanding debt maturing in 2011. We currently do not have a revolving line of credit, and we intend to continue to operate with a higher cash balance to compensate for our inability to manage our liquidity through a revolving facility.

At December 31, 2009 and 2008, the value and yield of the cash and investments in money market and other securities were as follows:

	2009		2008	
($ in millions)	**Value**	**Yield**	**Value**	**Yield**
Money market and other securities	$ 381.0	0.0%	$ 0.3	1.7%
Cash	20.7	0.1%	50.4	0.1%
Total	$ 401.7	0.0%	$ 50.7	0.1%

We invest otherwise uninvested cash in U.S. government- or agency-issued or guaranteed securities that are backed by the full faith and credit of the United States, or in high quality, short-term securities. We place our cash with financial institutions and, at times, cash held in checking accounts in financial institutions may be in excess of the Federal

Deposit Insurance Corporation insured limit.

We employ an asset-liability management approach that focuses on matching the estimated maturities of our investment portfolio to the estimated maturities of our borrowings. We evaluate our interest rate exposure on an ongoing basis. Generally, we seek to fund our primarily fixed-rate debt portfolio and our equity portfolio with fixed-rate debt or equity capital. To the extent deemed necessary, we may hedge variable and short-term interest rate exposure through interest rate swaps or other techniques.

During the year ended December 31, 2009, we sold no new equity in public offerings. During the years ended December 31, 2008 and 2007, we sold new equity of $402.5 million and $171.3 million, respectively, in public offerings. In addition, shareholders equity increased by $5.4 million and $31.5 million, through the exercise of stock options, the collection of notes receivable from the sale of common stock, and the issuance of shares through our dividend reinvestment plan during the years ended December 31, 2008, and 2007, respectively. Shareholders equity also increased by $26.4 million during the year ended December 31, 2008, as a result of the distribution of the common stock held in deferred compensation trusts. For the year ended December 31, 2007, shareholders equity decreased by $52.8 million for the cash portion of the option cancellation payment made in connection with our tender offer. See Results of Operations, Stock Option Expense, Options Cancelled in Connection with Tender Offer. See Note 8, Employee Compensation Plans. and Note 13, Financial Highlights from our Notes to the Consolidated Financial Statements, included in Item 8, for further detail on the change in shareholders equity for the periods.

At December 31, 2009 and 2008, we had outstanding debt as follows:

	2009			2008		
($ in millions)	**Facility Amount**	**Amount Outstanding**	**Annual Interest Cost(1)**	**Facility Amount**	**Amount Outstanding**	**Annual Interest Cost(1)**
Notes payable:						
Privately issued secured notes payable	$ 673.2	$ 673.2(5)	13.0%	$ 1,015.0	$ 1,015.0	7.8%
Publicly issued unsecured notes payable	745.5	745.5	6.7%	880.0	880.0	6.7%
Total notes payable	1,418.7	1,418.7	9.7%	1,895.0	1,895.0	7.3%
Bank term debt (former revolver)(2)	41.1	41.1	16.0%(3)	632.5	50.0	4.3%(3)
Total debt	$ 1,459.8	$ 1,459.8	9.8%(4)	$ 2,527.5	$ 1,945.0	7.7%(4)

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

(2) At December 31, 2008, $460.2 million, remained unused on the revolving line of credit, net of amounts committed for standby letters of credit of $122.3 million issued under the credit facility.

(3) The annual interest cost reflects the interest rate payable for borrowings under the bank debt facility in effect at the balance sheet date. In addition to the current interest rate payable, annual costs of commitment fees, other facility fees and amortization of debt financing costs related to the bank term debt are $3.1 million and $8.5 million at December 31, 2009 and 2008, respectively.

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

(5)

The notes payable on the consolidated balance sheet are shown net of OID of approximately $33.8 million as of December 31, 2009.

Privately Issued Debt

At December 31, 2009, we had outstanding privately issued notes (the Notes) of $673.2 million and $41.1 million outstanding under our bank facility (the Facility). The Notes and the Facility were restructured on August 28, 2009. Beginning in January 2009, we engaged in discussions with the revolving line of credit lenders (the Lenders) and the private noteholders (the Noteholders) to seek relief under certain terms of both the Facility and the Notes due to certain covenant defaults. As of December 31, 2008, our asset coverage was less than the 200% then required by the revolving credit facility and the private notes. Asset coverage generally refers to the percentage resulting from assets less accounts payable and other liabilities, divided by total debt.

In connection with the restructuring, we granted the Noteholders and the Lenders a pari-passu blanket lien on a substantial portion of our assets, including a substantial portion of the assets of our consolidated subsidiaries.

The financial covenants applicable to the Notes and the Facility were modified as part of the restructuring. The Consolidated Debt to Consolidated Shareholders Equity covenant and the Capital Maintenance covenant were both eliminated. The Asset Coverage ratio was set at 1.35:1 initially, increasing to 1.4:1 at June 30, 2010 and to 1.55:1 at June 30, 2011, and maintained at that level thereafter. A new covenant, Total Adjusted Assets to Secured Debt, was set at 1.75:1 initially, increasing to 2.0:1 at June 30, 2010 and to 2.25:1 at June 30, 2011, and maintained at that level thereafter. The ratio of Adjusted EBIT to Adjusted Interest Expense was set at 1.05:1 initially, decreasing to 0.95:1 at December 31, 2009, 0.80:1 at March 31, 2010 and 0.75:1 at June 30, 2010. The covenant will then be increased to 0.80:1 on December 31, 2010 and 0.95:1 on December 31, 2011 and maintained at that level thereafter.

The Notes and Facility impose certain limitations on our ability to incur additional indebtedness, including precluding us from incurring additional indebtedness unless our asset coverage of all outstanding indebtedness is at least 200%. Pursuant to the 1940 Act, the Company is not permitted to issue indebtedness unless immediately after such issuance the Company has asset coverage of all outstanding indebtedness of at least 200%. At December 31, 2009, our asset coverage ratio was 180%, which is less than the 200% requirement. We are not be able to issue additional indebtedness unless our asset coverage is at least 200%.

The Notes required us to apply 50% of all net cash proceeds from asset sales to the repayment of the Notes and the Facility required us to apply 6% of all net cash proceeds from asset sales to the repayment of the Facility, subject to certain conditions and exclusions. In the case of certain events of default, we would be required to apply 100% of all net cash proceeds from asset sales to the repayment of its secured lenders. Subject to a limit and certain liquidity restrictions, the Notes and the Facility allowed us to repurchase our own public debt; however, they prohibited us from repurchasing our common stock and from paying dividends in excess of the minimum we reasonably believe is required to maintain our tax status as a regulated investment company. In addition, upon the occurrence of a change of control (as defined in the Note Agreement and Credit Agreement), the Noteholders have the right to be prepaid in full and we are required to repay in full all amounts outstanding under the Facility.

The Note Agreement and Credit Agreement provide for customary events of default, including, but not limited to, payment defaults, breach of representations or covenants, cross-defaults, bankruptcy events and failure to pay judgments. Certain of these events of default are subject to notice and cure periods or materiality thresholds. Pursuant to the terms of the Notes, the occurrence of an event of default generally permits the holders of more than 50% in principal amount of outstanding Notes to accelerate repayment of all amounts due thereunder. The occurrence of an event of default would generally permit the administrative agent for the lenders under the Facility, or the holders of more than 51% of the aggregate principal debt outstanding under the Facility, to accelerate repayment of all amounts outstanding thereunder. Pursuant to the Notes, during the continuance of an event of default, the rate of interest applicable to the Notes would increase by 200 basis points. Pursuant to the terms of the Facility, during the continuance of an event of default, the applicable spread on any borrowings outstanding under the Facility would increase by 200 basis points.

Privately Issued Notes Payable. In connection with the restructuring, the existing Notes were exchanged for three new series of Notes containing the following terms:

($ in millions)	Principal Amount(1)	Maturity Dates	Annual Stated Interest Rate Through December 31, 2009(2)	Annual Stated Interest Rate Beginning January 1, 2010(2)	Annual Stated Interest Rate Beginning January 1, 2011(2)	Annual Stated Interest Rate Beginning January 1, 2012(2)
Series A	$ 253.8	June 15, 2010	8.50%	9.25%	N/A	N/A
Series B	$ 253.8	June 15, 2011	9.00%	9.50%	9.75%	N/A
Series C	$ 333.5	March 31 & April 1, 2012	9.50%	10.00%	10.25%	10.75%

(1) Amount outstanding at closing on August 28, 2009.

(2) The Notes generally require payment of interest quarterly.

We made various cash payments in connection with the restructuring of our Notes. We paid an amendment fee at closing of $15.2 million. In addition, we paid a make-whole fee of $79.7 million related to a contractual provision in the old Notes. Due to the payment of this make-whole fee, the new Notes have no significant make-whole requirement. We also paid a restructuring fee of $50.0 million at closing, which would be applied toward the principal balance of the Notes if the Notes were refinanced in full on or before January 31, 2010. See Debt Refinance below.

Bank Facility. Our Facility was restructured from a revolving facility to a term facility maturing on November 13, 2010. Borrowings under the Facility bear interest at a floating rate of interest, subject to a floor. The floating rate spread increases by 0.5% per annum beginning on January 1, 2010 and continuing through maturity. At closing, the interest rate on the Facility was 8.5% per annum. The Facility requires the payment of a commitment fee equal to 0.50% per annum of the committed amount. In addition, the Company agreed to pay an amendment fee at closing of $1.0 million, and a restructuring fee payable on January 31, 2010 equal to 1.0% of the outstanding borrowings on such date if the Facility remains outstanding. The Facility generally requires payments of interest no less frequently than quarterly.

Private Debt Refinance. On January 29, 2010, we repaid the Notes and the Facility (collectively, the Existing Private Debt) in full using cash on hand from asset sales and repayments and proceeds from a new term loan. In addition, by repaying the Notes before January 31, 2010, we were able to apply the $50.0 million restructuring fee paid at closing of the August 2009 restructure toward the principal balance of the Notes. In connection with the repayment and refinancing, we entered into a Second Amended and Restated Credit Agreement (the Amended Credit Agreement) pursuant to which we obtained a senior secured term loan in the aggregate amount of $250 million (the Term Loan). On January 29, 2010, after giving effect to the refinancing and the full repayment of the Existing Private Debt, we had total outstanding debt of $995.5 million and cash and investments in money market and other securities of approximately $128 million.

The Term Loan matures on February 28, 2011. We are required to make mandatory repayments of the Term Loan (i) using 56% of all net cash proceeds from asset dispositions, subject to certain conditions and exclusions, (ii) using

100% of proceeds from any unsecured debt issuance, (iii) using 100% of available cash in excess of $125 million at any month end and (iv) to cure any borrowing base deficiencies, as discussed below. In addition, the Term Loan must be repaid in full if at any time the outstanding principal balance is less than or equal to $25 million and our available cash is then equal to or greater than $125 million. The Term Loan generally becomes due and payable in full upon the occurrence of a change of control; except that, in certain circumstances, the Term Loan may be assumed by Ares Capital in connection with the consummation of the merger contemplated by the Agreement and Plan of Merger, dated as of October 26, 2009, among Ares Capital, ARCC Odyssey Corp. and us.

At our election, borrowings under the Term Loan will generally bear interest at a rate per annum equal to (i) LIBOR plus 4.50% or (ii) 2.00% plus the higher of (a) the JPMorgan Chase Bank, N.A. prime rate, (b) the daily one-month LIBOR plus 2.5%, and (c) the federal funds effective rate plus 0.5%.

In addition to the interest paid on the Term Loan, we incurred other fees and costs associated with the repayment and refinancing and will also incur additional exit fees, which increase over the term of the loan, as the Term Loan is repaid.

Consistent with the terms of the Existing Private Debt, we have granted the Term Loan lenders a blanket lien on a substantial portion of our assets. Borrowings under the Term Loan are subject to a requirement that the borrowing base (as defined in the Amended Credit Agreement) be greater than 2.5x the outstanding principal balance of the Term Loan at any time such outstanding principal balance is greater than $175 million, and greater than 2.0x at any time such outstanding principal balance is less than or equal to $175 million. If the borrowing base falls below the minimum coverage requirement, we are required to make repayments of the Term Loan in an amount sufficient to bring the coverage ratio to the required level.

The Amended Credit Agreement contains various operating covenants applicable to us. The Term Loan requires that we maintain a ratio of Adjusted EBIT to Adjusted Interest Expense (as such terms are defined in the Amended Credit Agreement) of not less than 0.70:1.0, measured as of the last day of each fiscal quarter as provided in the Amended Credit Agreement. In addition, we are precluded from incurring additional indebtedness unless our asset coverage of all outstanding indebtedness is at least 200% and may not pay dividends in excess of the minimum we reasonably believe is required to maintain our tax status as a regulated investment company.

The Amended Credit Agreement contains customary events of default, including, but not limited to, payment defaults, breach of representations or covenants, cross-defaults, bankruptcy events and failure to pay judgments. Certain of these events of default are subject to notice and cure periods or materiality thresholds. The occurrence of an event of default would permit the administrative agent for the lenders under the Term Loan, or the holders of more than 51% of the aggregate principal debt outstanding under the Term Loan, to declare the entire unpaid principal balance outstanding due and payable. Pursuant to the terms of the Amended Credit Agreement, during the continuance of an event of default, at the election of the required lenders, the applicable interest on any outstanding principal amount of the Term Loan would increase by 200 basis points.

Publicly Issued Unsecured Notes Payable. At December 31, 2009, we had outstanding publicly issued unsecured notes as follows:

($ in millions)	**Amount**	**Maturity Date**
6.625% Notes due 2011	$ 319.9	July 15, 2011
6.000% Notes due 2012	195.6	April 1, 2012
6.875% Notes due 2047	230.0	April 15, 2047
Total	$ 745.5	

The 6.625% Notes due 2011 and the 6.000% Notes due 2012 require payment of interest only semi-annually, and all principal is due upon maturity. We have the option to redeem these notes in whole or in part, together with a redemption premium, if any, as stipulated in the notes.

The 6.875% Notes due 2047 require payment of interest quarterly, and all principal is due upon maturity. These notes are redeemable in whole or in part at any time or from time to time on or after April 15, 2012, at par and upon the occurrence of certain tax events as stipulated in the notes. These notes are listed on the New York Stock Exchange under the trading symbol AFC.

We have certain financial and operating covenants that are required by the publicly issued unsecured notes payable. We are not permitted to issue indebtedness unless immediately after such issuance we have asset coverage of all outstanding indebtedness of at least 200% as required by the 1940 Act, as amended. At December 31, 2009, our asset coverage ratio was 180%, which is less than the 200% requirement.

Contractual Obligations. The following table shows our significant contractual obligations for the repayment of debt and payment of other contractual obligations as of December 31, 2009.

($ in millions)	Total	2010	2011	2012	2013	2014	After 2014
	Payments Due By Year						
Privately issued secured notes payable	$ 673.2	$ 86.0	$ 253.8	$ 333.5	$	$	$
Publicly issued unsecured notes payable	745.5		319.9	195.6			230.0
Bank facility (former revolver)	41.1	41.1					
Operating leases	10.7	4.4	1.7	1.7	1.7	1.2	
Total contractual obligations	$ 1,470.5	$ 131.5	$ 575.4	$ 530.8	$ 1.7	$ 1.2	$ 230.0

Off-Balance Sheet Arrangements

In the ordinary course of business, we have issued guarantees through financial intermediaries on behalf of certain portfolio companies. We generally have issued guarantees for the benefit of counterparties to certain portfolio companies. Under these arrangements, we would be required to make payments to third parties if the portfolio companies were to default on their related payment obligations or if the expiration date of the letters of credit is not extended. The following table shows our guarantees that may have the effect of creating, increasing, or accelerating our liabilities as of December 31, 2009.

($ in millions)	Total	2010	2011	2012	2013	2014	After 2014
	Amount of Commitment Expiration Per Year						
Guarantees	$ 9.1	$ 8.2	$	$ 0.1	$	$	$ 0.8

At December 31, 2009, we had outstanding investment commitments totaling $153.8 million. We intend to fund these commitments with existing cash and through cash flow from operations before new investments although there can be no assurance that we will generate sufficient cash flow to satisfy these commitments. Should we not be able to satisfy these commitments, there could be a material adverse effect on our financial condition, liquidity and results of operations.

CRITICAL ACCOUNTING POLICIES

The consolidated financial statements are based on the selection and application of critical accounting policies, which require management to make significant estimates and assumptions. Critical accounting policies are those that are both important to the presentation of our financial condition and results of operations and require management s most difficult, complex, or subjective judgments. Our critical accounting policies are those applicable to the valuation of investments, certain revenue recognition matters and certain tax matters as discussed below.

Valuation of Portfolio Investments. We, as a BDC, have invested in illiquid securities including debt and equity securities of portfolio companies, CLO bonds and preferred shares/income notes, CDO bonds and investment funds. Our investments may be subject to certain restrictions on resale and generally have no established trading market. We value substantially all of our investments at fair value as determined in good faith by the Board of Directors in accordance with our valuation policy and the provisions of the Investment Company Act of 1940 and 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. Our valuation policy considers the fact that no ready market exists for substantially all of the securities in which we invest and that fair value for our investments must typically be determined using unobservable inputs. Our valuation policy is intended to provide a consistent basis for determining the fair value of the portfolio.

We adopted the standards in ASC Topic 820 on a prospective basis in the first quarter of 2008. These standards require us to assume that the portfolio investment is to be sold in the principal market to market participants, or in the absence of a principal market, the most advantageous market, which may be a hypothetical market. Market participants are defined as buyers and sellers in the principal or most advantageous market that are independent, knowledgeable, and willing and able to transact. In accordance with the standards, we have considered our principal market, or the market in which we exit our portfolio investments with the greatest volume and level of activity.

We have determined that for our buyout investments, where we have control or could gain control through an option or warrant security, both the debt and equity securities of the portfolio investment would exit in the merger and acquisition (M&A) market as the principal market generally through a sale or recapitalization of the portfolio company. We believe that the in-use premise of value (as defined in ASC Topic 820), which assumes the debt and equity securities are sold together, is appropriate as this would provide maximum proceeds to the seller. As a result, we use the enterprise value methodology to determine the fair value of these investments. Enterprise value means the entire value of the company to a market participant, including the sum of the values of debt and equity securities used to capitalize the enterprise at a point in time. Enterprise value is determined using various factors, including cash flow from operations of the portfolio company, multiples at which private companies are bought and sold, and other pertinent factors, such as recent offers to purchase a portfolio company, recent transactions involving the purchase or sale of the portfolio company s equity securities, liquidation events, or other events. We allocate the enterprise value to these securities in order of the legal priority of the securities.

While we typically exit our securities upon the sale or recapitalization of the portfolio company in the M&A market, for investments in portfolio companies where we do not have control or the ability to gain control through an option or warrant security, we cannot typically control the exit of our investment into our principal market (the M&A market). As a result, in accordance with ASC Topic 820, we are required to determine the fair value of these investments assuming a sale of the individual investment (the in-exchange premise of value) in a hypothetical market to a hypothetical market participant. We continue to perform an enterprise value analysis for the investments in this category to assess the credit risk of the loan or debt security and to determine the fair value of our equity investment in these portfolio companies. The determined equity values are generally discounted when we have a minority ownership position, restrictions on resale, specific concerns about the receptivity of the capital markets to a specific company at a certain time, or other factors. For loan and debt securities, we perform a yield analysis assuming a hypothetical current sale of the investment. The yield analysis requires us to estimate the expected repayment date of the instrument and a market participant s required yield. Our estimate of the expected repayment date of a loan or debt security may be shorter than the legal maturity of the instruments as our loans historically have been repaid prior to the maturity date. The yield analysis considers changes in interest rates and changes in leverage levels of the loan or debt security as compared to market interest rates and leverage levels. Assuming the credit quality of the loan or debt security remains stable, we will use the value determined by the yield analysis as the fair value for that security. A change in the assumptions that we use to estimate the fair value of our loans and debt securities using a yield analysis could have a material impact on the determination of fair value. If there is deterioration in credit quality or a loan or debt security is in workout status, we may consider other factors in determining the fair value of a loan or debt security, including the value attributable to the loan or debt security from the enterprise value of the portfolio company or the proceeds that would be received in a liquidation analysis.

Our equity investments in private debt and equity funds are generally valued based on the amount that we believe would be received if the investments were sold and consider the fund s net asset value, observable transactions and other factors. The value of our equity securities in public companies for which quoted prices in an active market are readily available is based on the closing public market price on the measurement date.

The fair value of our CLO bonds and preferred shares/income notes and CDO bonds (CLO/CDO Assets) is generally based on a discounted cash flow model that utilizes prepayment, re-investment, loss and ratings assumptions based on historical experience and projected performance, economic factors, the characteristics of the underlying cash flow, and comparable yields for similar bonds and preferred shares/income notes, when available. We recognize unrealized appreciation or depreciation on our CLO/CDO Assets as comparable yields in the market change and/or based on changes in estimated cash flows resulting from changes in prepayment, re-investment, loss or ratings assumptions in the underlying collateral pool, or changes in redemption assumptions for the CLO/CDO Assets, if applicable. We determine the fair value of our CLO/CDO Assets on an individual security-by-security basis.

We record unrealized depreciation on investments when we determine that the fair value of a security is less than its cost basis, and record unrealized appreciation when we determine that the fair value is greater than its cost basis. Because of the inherent uncertainty of valuation, the values determined at the measurement date 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. Additionally, changes in the market environment and other events that may occur over the life of the investments may cause the gains or losses ultimately realized on these investments to be different than the values determined at the measurement date. In accordance with ASC Topic 820 (discussed below), we do not consider a transaction price that is associated with a transaction that is not orderly to be indicative of fair value or market participant risk premiums, and accordingly would place little, if any, weight on transactions that are not orderly in determining fair value. When considering recent potential or completed transactions, we use judgment in determining if such offers or transactions were pursuant to an orderly process for purposes of determining how much weight is placed on these data points in accordance with the applicable guidelines in ASC Topic 820.

See Results of Operations Change in Unrealized Appreciation or Depreciation above for more discussion on portfolio valuation.

Net Realized Gains or Losses and Net Change in Unrealized Appreciation or Depreciation. Realized gains or losses are measured by the difference between the net proceeds from the repayment or sale and the cost basis of the investment without regard to unrealized appreciation or depreciation previously recognized, and include investments charged off during the period, net of recoveries. Net change in unrealized appreciation or depreciation primarily reflects the change in portfolio investment values during the reporting period, including the reversal of previously recorded unrealized appreciation or depreciation when gains or losses are realized. Net change in unrealized appreciation or depreciation also reflects the change in the value of U.S. Treasury bills, when applicable, and depreciation on accrued interest and dividends receivable and other assets where collection is doubtful.

Interest and Dividend Income. Interest income is recorded on an accrual basis to the extent that such amounts are expected to be collected. For loans and debt securities with contractual payment-in-kind interest, which represents contractual interest accrued and added to the loan balance that generally becomes due at maturity, we will not accrue payment-in-kind interest if the portfolio company valuation indicates that the payment-in-kind interest is not collectible. In general, interest is not accrued on loans and debt securities if we have doubt about interest collection or where the enterprise value of the portfolio company may not support further accrual. Interest may not accrue on loans or debt securities to portfolio companies that are more than 50% owned by us depending on such company s capital requirements.

When we receive nominal cost warrants or free equity securities (nominal cost equity), we allocate our cost basis in our investment between debt securities and nominal cost equity at the time of origination. At that time, the original issue discount basis of the nominal cost equity is recorded by increasing the cost basis in the equity and decreasing the cost basis in the related debt securities. Loan origination fees, original issue discount, and market discount are capitalized and then amortized into interest income using a method that approximates the effective interest method. Upon the prepayment of

a loan or debt security, any unamortized loan origination fees are recorded as interest income and any unamortized original issue discount or market discount is recorded as a realized gain.

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 loans and debt securities at value. The weighted average yield is computed as of the balance sheet date.

We recognize interest income on the CLO preferred shares/income notes using the effective interest method, based on the anticipated yield that is determined using the estimated cash flows over the projected life of the investment. Yields are revised when there are changes in actual or estimated cash flows due to changes in prepayments and/or re-investments, credit losses, ratings or asset pricing. Changes in estimated yield are recognized as an adjustment to the estimated yield over the remaining life of the preferred shares/income notes from the date the estimated yield was changed. CLO and CDO bonds have stated interest rates. The weighted average yield on the CLO/CDO Assets is calculated as the (a) annual stated interest or the effective interest yield on the accruing bonds or the effective yield on the preferred shares/income notes, divided by (b) CLO/CDO Assets at value. The weighted average yields are computed as of the balance sheet date.

Dividend income on preferred equity securities is recorded as dividend income on an accrual basis to the extent that such amounts are expected to be collected and to the extent that we have the option to receive the dividend in cash. Dividend income on common equity securities is recorded on the record date for private companies or on the ex-dividend date for publicly traded companies.

Fee Income. Fee income includes fees for loan prepayment premiums, guarantees, commitments, and services rendered by us to portfolio companies and other third parties such as diligence, structuring, transaction services, management and consulting services, and other services. Loan prepayment premiums are recognized at the time of prepayment. Guaranty and commitment fees are generally recognized as income over the related period of the guaranty or commitment, respectively. Diligence, structuring, and transaction services fees are generally recognized as income when services are rendered or when the related transactions are completed. Management, consulting and other services fees, including fund management fees, are generally recognized as income as the services are rendered. Fees are not accrued if we have doubt about collection of those fees.

Federal and State Income Taxes and Excise Tax. We have complied with the requirements of the Internal Revenue Code that are applicable to regulated investment companies (RIC) and real estate investment trusts (REIT). We and any of our subsidiaries that qualify as a RIC or a REIT intend to distribute or retain through a deemed distribution all of our annual taxable income to shareholders; therefore, we have made no provision for income taxes exclusive of excise taxes for these entities.

If we do not distribute at least 98% of our annual taxable income in the year earned, we will generally be required to pay an excise tax equal to 4% of the amount by which 98% of our annual taxable income exceeds the distributions from such taxable income during the year earned. To the extent that we determine that our estimated current year annual taxable income will be in excess of estimated current year dividend distributions from such taxable income, we accrue excise taxes on estimated excess taxable income as taxable income is earned using an annual effective excise tax rate. The annual effective excise tax rate is determined by dividing the estimated annual excise tax by the estimated annual taxable income.

Income taxes for AC Corp are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases as well as operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

Recent Accounting Pronouncements. *Fair Value Measurements*. In September 2006, the FASB issued Statement No. 157, which was primarily codified into ASC Topic 820, and which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. We adopted this statement on a prospective basis beginning in the quarter ended March 31, 2008. The initial adoption of this statement did not have a material effect on our consolidated financial statements.

ASC Topic 820 also includes the codification of *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (FSP 157-4), which was issued by the FASB in April 2009. These provisions provide guidance on how to determine the fair value of assets under ASC Topic 820 in the current economic environment and reemphasize that the objective of a fair value measurement remains an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. These provisions state that a transaction price that is associated with a transaction that is not orderly is not determinative of fair value or market-participant risk premiums and companies should place little, if any, weight (compared with other indications of fair value) on transactions that are not orderly when estimating fair value or market risk premiums.

We adopted these provisions of ASC Topic 820 on a prospective basis beginning in the quarter ending March 31, 2009. The adoption of these provisions did not have a material effect on our consolidated financial statements.

Subsequent Events (SFAS 165). In May 2009, the FASB issued SFAS 165, which was primarily codified into ASC Topic 855, which establishes general standards for reporting events that occur after the balance sheet date, but before financial statements are issued or are available to be issued. This standard requires the disclosure of the date through which an entity has evaluated subsequent events and whether that date represents the date the financial statements were issued or were available to be issued.

We adopted these provisions of Topic 855 in the quarter ended June 30, 2009. The adoption of these provisions did not have a material impact on our financial statements.

Accounting for Transfers of Financial Assets (SFAS 166), which was codified into ASC Topic 860, *Transfers and Servicing*. In June 2009, the FASB issued SFAS 166, which changes the conditions for reporting a transfer of a portion of a financial asset as a sale and requires additional year-end and interim disclosures. SFAS 166 is effective for fiscal years beginning after November 15, 2009. The implementation of SFAS 166 is not expected to have a material impact on our financial statements.

Amendments to FASB Interpretation No. 46(R) (SFAS 167), which will be codified into ASC Topic 810, *Consolidation*. In June 2009, the FASB issued SFAS 167, which amends the guidance on accounting for variable interest entities. SFAS 167 is effective for fiscal years beginning after November 15, 2009 and interim periods within that fiscal year. We have not completed the process of evaluating the impact of adopting this standard.

The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles (SFAS 168), which was primarily codified into ASC Topic 105, was issued by the FASBin July 2009. This standard establishes the FASB Accounting Standards Codification, which will become the source of authoritative U.S. generally accepted accounting principles recognized by the FASB. This standard is effective for the period ending after September 15, 2009. The implementation of this standard did not have a material impact on our financial statements.

Item 7A. Quantitative and Qualitative Disclosure about Market Risk.

Our business activities contain elements of risk. We consider the principal types of market risk to be fluctuations in interest rates. We consider the management of risk essential to conducting our businesses. Accordingly, our risk management systems and procedures are designed to identify and analyze our risks, to set appropriate policies and limits and to continually monitor these risks and limits by means of reliable administrative and information systems and other policies and programs.

Because we borrow money to make investments, our net investment income is dependent upon the difference between the rate at which we borrow funds and the rate at which we invest these funds. As a result, there can be no assurance that a significant change in market interest rates will not have a material adverse effect on our net investment income. In periods of rising interest rates, our cost of funds would increase, which would reduce our net investment income. We use a combination of long-term and short-term borrowings and equity capital to finance our investing activities. Our long-term fixed-rate investments are financed primarily with long-term fixed-rate debt and equity. We may use interest rate risk management techniques in an effort to limit our exposure to interest rate fluctuations. Such techniques may include various interest rate hedging activities to the extent permitted by the 1940 Act. We have analyzed the potential impact of changes in interest rates on interest income net of interest expense.

At December 31, 2009, 79% of our private finance loans and debt securities carried a fixed rate of interest and 21% carried a floating rate of interest. The mix of fixed and variable rate loans and debt securities in the portfolio may vary depending on the level of floating rate senior loans or unitranche debt in the portfolio at a given time.

Assuming that the balance sheet as of December 31, 2009, were to remain constant and no actions were taken to alter the existing interest rate sensitivity, a hypothetical immediate 1% change in interest rates would have affected net income by approximately $2.4 million over a one year horizon. Although management believes that this measure is indicative of our sensitivity to interest rate changes, it does not adjust for potential changes in credit quality, size and composition of the assets on the balance sheet and other business developments that could affect net increase in net assets resulting from operations, or net income. Accordingly, no assurances can be given that actual results would not differ materially from the potential outcome simulated by this estimate.

In addition, we may have risk regarding portfolio valuation. See Item 1. Business Portfolio Valuation above.

Item 8. ***Financial Statements and Supplementary Data.***

Management s Report on Internal Control over Financial Reporting

The management of Allied Capital Corporation and subsidiaries (the Company) is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f). Under the supervision and with the participation of management, including the Chairman of the Board, Chief Executive Officer, Chief Financial Officer and Chief Accounting Officer, the Company conducted an evaluation of the effectiveness of the Company s internal control over financial reporting based on the criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on the Company s evaluation under the framework in *Internal Control Integrated Framework,* management concluded that the Company s internal control over financial reporting was effective as of December 31, 2009. KPMG LLP, the Company s independent registered public accounting firm, has issued an attestation report on the effectiveness of the Company s internal control over financial reporting as of December 31, 2009, as stated in its report which is included herein.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders
Allied Capital Corporation:

We have audited Allied Capital Corporation and subsidiaries (the Company) internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Allied Capital Corporation s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management s Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Allied Capital Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Allied Capital Corporation and subsidiaries as of December 31, 2009 and 2008, including the consolidated statements of investments as of December 31, 2009 and 2008, and the related consolidated statements of operations, changes in net assets and cash flows, and the financial highlights (included in Note 13), for each of the years in the three-year period ended December 31, 2009, and our report dated February 26, 2010, expressed an unqualified opinion on those consolidated financial statements.

Washington, D.C.
February 26, 2010

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders
Allied Capital Corporation:

We have audited the accompanying consolidated balance sheet of Allied Capital Corporation and subsidiaries (the Company) as of December 31, 2009 and 2008, including the consolidated statements of investments as of December 31, 2009 and 2008, and the related consolidated statements of operations, changes in net assets and cash flows, and the financial highlights (included in Note 13), for each of the years in the three-year period ended December 31, 2009. These consolidated financial statements and financial highlights are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements and financial highlights based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and financial highlights are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our procedures included physical inspection or confirmation of securities owned as of December 31, 2009 and 2008. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements and financial highlights referred to above present fairly, in all material respects, the financial position of Allied Capital Corporation and subsidiaries as of December 31, 2009 and 2008, and the results of their operations, their cash flows, changes in their net assets, and financial highlights for each of the years in the three-year period ended December 31, 2009, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 2 to the consolidated financial statements, the Company modified its method of determining the fair value of portfolio investments in 2008 due to the adoption of Statement of Financial Accounting Standards No. 157, *Fair Value Measurements.*

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Allied Capital Corporation s internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 26, 2010, expressed an unqualified opinion on the effectiveness of the Company s internal control over financial reporting.

Washington, D.C.
February 26, 2010

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

(in thousands, except per share amounts)	December 31, 2009	December 31, 2008
ASSETS		
Portfolio at value:		
Private finance		
Companies more than 25% owned (cost: 2009-$1,747,759; 2008-$2,167,020)	$ 811,736	$ 1,187,722
Companies 5% to 25% owned (cost: 2009-$222,981; 2008-$392,516)	180,998	352,760
Companies less than 5% owned (cost: 2009-$1,639,193; 2008-$2,317,856)	1,082,577	1,858,581
Total private finance (cost: 2009-$3,609,933; 2008-$4,877,392)	2,075,311	3,399,063
Commercial real estate finance (cost: 2009-$75,180; 2008-$85,503)	55,807	93,887
Total portfolio at value (cost: 2009-$3,685,113; 2008-$4,962,895)	2,131,118	3,492,950
Accrued interest and dividends receivable	43,875	55,638
Other assets	88,802	122,909
Investments in money market and other securities	381,020	287
Cash	20,682	50,402
Total assets	$ 2,665,497	$ 3,722,186
LIABILITIES AND SHAREHOLDERS EQUITY		
Liabilities:		
Notes payable (maturing within one year: 2009-$85,111; 2008-$1,015,000)	$ 1,384,920	$ 1,895,000
Bank secured term debt (former revolver)	41,091	50,000
Accounts payable and other liabilities	41,284	58,786
Total liabilities	1,467,295	2,003,786
Commitments and contingencies		
Shareholders equity:		
Common stock, $0.0001 par value, 400,000 shares authorized; 179,940 and 178,692 shares issued and outstanding at December 31, 2009 and 2008, respectively	18	18
Additional paid-in capital	3,037,513	3,037,845
Notes receivable from sale of common stock	(301)	(1,089)
Net unrealized appreciation (depreciation)	(1,679,778)	(1,503,089)
Undistributed (distributions in excess of) earnings	(159,250)	184,715
Total shareholders equity	1,198,202	1,718,400
Total liabilities and shareholders equity	$ 2,665,497	$ 3,722,186

Net asset value per common share	$ 6.66	$ 9.62

The accompanying notes are an integral part of these consolidated financial statements.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF OPERATIONS

	For the Years Ended December 31,		
(in thousands, except per share amounts)	**2009**	**2008**	**2007**
Interest and Related Portfolio Income:			
Interest and dividends			
Companies more than 25% owned	$ 93,739	$ 111,188	$ 105,634
Companies 5% to 25% owned	30,028	42,376	41,577
Companies less than 5% owned	167,219	303,854	270,365
Total interest and dividends	290,986	457,418	417,576
Fees and other income			
Companies more than 25% owned	23,382	28,278	18,505
Companies 5% to 25% owned	234	2,619	810
Companies less than 5% owned	4,084	12,797	24,814
Total fees and other income	27,700	43,694	44,129
Total interest and related portfolio income	318,686	501,112	461,705
Expenses:			
Interest	171,068	148,930	132,080
Employee	42,104	76,429	89,155
Employee stock options	3,355	11,781	35,233
Administrative	38,147	49,424	50,580
Impairment of long-lived assets	2,873		
Total operating expenses	257,547	286,564	307,048
Net investment income before income taxes	61,139	214,548	154,657
Income tax expense, including excise tax	5,576	2,506	13,624
Net investment income	55,563	212,042	141,033
Net Realized and Unrealized Gains (Losses):			
Net realized gains (losses)			
Companies more than 25% owned	(149,032)	(131,440)	226,437
Companies 5% to 25% owned	(49,484)	(14,120)	(10,046)
Companies less than 5% owned	(162,612)	16,142	52,122
Total net realized gains (losses)	(361,128)	(129,418)	268,513
Net change in unrealized appreciation or depreciation	(176,689)	(1,123,762)	(256,243)
Total net gains (losses)	(537,817)	(1,253,180)	12,270

Gain on repurchase of debt	83,532	1,132	
Loss on extinguishment of debt	(122,776)		
Net increase (decrease) in net assets resulting from operations	$ (521,498)	$ (1,040,006)	$ 153,303
Basic earnings (loss) per common share	$ (2.91)	$ (6.01)	$ 1.00
Diluted earnings (loss) per common share	$ (2.91)	$ (6.01)	$ 0.99
Weighted average common shares outstanding basic	178,994	172,996	152,876
Weighted average common shares outstanding diluted	178,994	172,996	154,687

The accompanying notes are an integral part of these consolidated financial statements.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN NET ASSETS

(in thousands, except per share amounts)	For the Years Ended December 31, 2009	2008	2007
Operations:			
Net investment income	$ 55,563	$ 212,042	$ 141,033
Net realized gains (losses)	(361,128)	(129,418)	268,513
Net change in unrealized appreciation or depreciation	(176,689)	(1,123,762)	(256,243)
Gain on repurchase of debt	83,532	1,132	
Loss on extinguishment of debt	(122,776)		
Net increase (decrease) in net assets resulting from operations	(521,498)	(1,040,006)	153,303
Shareholder distributions:			
Common stock dividends		(456,531)	(407,317)
Preferred stock dividends	(10)	(10)	(10)
Net decrease in net assets resulting from shareholder distributions	(10)	(456,541)	(407,327)
Capital share transactions:			
Sale of common stock		402,478	171,282
Issuance of common stock in lieu of cash distributions		3,751	17,095
Issuance of common stock upon the exercise of stock options	918		14,251
Cash portion of option cancellation payment			(52,833)
Stock option expense	3,424	11,906	35,810
Cancellation of common stock (note receivable from common stock)	(36)		
Net decrease in notes receivable from sale of common stock	788	1,603	158
Purchase of common stock held in deferred compensation trust		(943)	(12,444)
Distribution of common stock held in deferred compensation trust		27,335	837
Other	(3,784)	(3,030)	10,471
Net increase in net assets resulting from capital share transactions	1,310	443,100	184,627
Total net increase (decrease) in net assets	(520,198)	(1,053,447)	(69,397)
Net assets at beginning of year	1,718,400	2,771,847	2,841,244
Net assets at end of year	$ 1,198,202	$ 1,718,400	$ 2,771,847
Net asset value per common share	$ 6.66	$ 9.62	$ 17.54
Common shares outstanding at end of year	179,940	178,692	158,002

The accompanying notes are an integral part of these consolidated financial statements.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS

(in thousands)	For the Years Ended December 31, 2009	2008	2007
Cash flows from operating activities:			
Net increase (decrease) in net assets resulting from operations	$ (521,498)	$ (1,040,006)	$ 153,303
Adjustments:			
Portfolio investments	(130,436)	(1,070,092)	(1,845,973)
Principal collections related to investment repayments or sales	871,271	1,037,348	1,211,550
Collections of notes and other consideration received from sale of investments	198,406	16,546	15,305
Realized gains from the receipt of notes and other consideration from sale of investments	(577)	(11,972)	(33,011)
Realized losses	413,783	279,886	131,997
Gain on repurchase of debt	(83,532)	(1,132)	
Redemption of (investment in) U.S. Treasury bills, money market and other securities	(380,733)	200,935	988
Payment-in-kind interest and dividends, net of cash collections	(33,839)	(53,364)	(11,997)
Change in accrued interest and dividends	10,653	14,860	(11,916)
Net collection (amortization) of discounts and fees	(7,173)	(13,083)	(4,101)
Stock option expense	3,424	11,906	35,810
Impairment of long-lived asset	2,873		
Changes in other assets and liabilities	(86,676)	(41,481)	(12,466)
Depreciation and amortization	1,536	913	2,064
Net change in unrealized (appreciation) or depreciation	176,689	1,123,762	256,243
Net cash provided by (used in) operating activities	434,171	455,026	(112,204)
Cash flows from financing activities:			
Sale of common stock		402,478	171,282
Sale of common stock upon the exercise of stock options	918		14,251
Collections of notes receivable from sale of common stock	752	1,603	158
Borrowings under notes payable		193,000	230,000
Repayments on notes payable	(392,136)	(217,080)	
Net borrowings under (repayments on) bank secured term debt (former revolver)	(8,909)	(317,250)	159,500
Cash portion of option cancellation payment			(52,833)
Purchase of common stock held in deferred compensation trust		(943)	(12,444)
Payment of deferred financing costs and other financing activities	(64,506)	(17,182)	1,798
Common stock dividends and distributions paid		(452,780)	(397,645)
Preferred stock dividends paid	(10)	(10)	(10)
Net cash provided by (used in) financing activities	(463,891)	(408,164)	114,057

Net increase (decrease) in cash		(29,720)		46,862		1,853
Cash at beginning of year		50,402		3,540		1,687
Cash at end of year	$	20,682	$	50,402	$	3,540

The accompanying notes are an integral part of these consolidated financial statements.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF INVESTMENTS

Private Finance Portfolio Company (in thousands, except number of shares)	**Investment[1][2]**	**December 31, 2009 Principal**	**Cost**	**Value**
Companies More Than 25% Owned				
AGILE Fund I, LLC[5]	Equity Interests		$ 637	$ 449
(Private Equity Fund)	**Total Investment**		**637**	**449**
AllBridge Financial, LLC	Senior Loan (6.3%, Due 4/10)	$ 1,500	1,500	1,500
(Asset Management)	Equity Interests		40,118	15,805
	Total Investment		**41,618**	**17,305**
Avborne, Inc.	Common Stock (27,500 shares)			39
(Business Services)	**Total Investment**			**39**
Aviation Properties Corporation	Common Stock (100 shares)		123	
(Business Services)	**Total Investment**		**123**	
Border Foods, Inc.	Senior Loan (12.9%, Due 3/12)	34,126	29,064	34,126
(Consumer Products)	Preferred Stock (100,000 shares)		12,721	20,901
	Common Stock (260,467 shares)		3,847	9,663
	Total Investment		**45,632**	**64,690**
Callidus Capital Corporation	Subordinated Debt (18.0%, Due 8/13)	21,782	21,782	19,108
(Asset Management)	Common Stock (100 shares)			
	Total Investment		**21,782**	**19,108**

	Guaranty ($3,189)			
Ciena Capital LLC	Senior Loan (5.5%, Due 3/09)[6]	319,031	319,031	100,051
(Financial Services)	Class B Equity Interests		119,436	
	Class C Equity Interests		109,097	
	Total Investment		**547,564**	**100,051**
	Guaranty ($5,000 See Note 3)			
CitiPostal Inc.	Senior Loan (3.7%, Due 12/13)	692	683	683
(Business Services)	Unitranche Debt (12.0%, Due 12/13)	50,801	50,633	50,633
	Subordinated Debt (16.0%, Due 12/15)	10,685	10,685	10,685
	Common Stock (37,024 shares)		12,726	1,432
	Total Investment		**74,727**	**63,433**
Coverall North America, Inc.	Unitranche Debt (12.0%, Due 7/11)	31,627	31,573	31,573
(Business Services)	Subordinated Debt (15.0%, Due 7/11)	5,563	5,555	5,555
	Common Stock (763,333 shares)		14,361	11,386
	Total Investment		**51,489**	**48,514**
Crescent Equity Corp.[8]	Senior Loan (10.0%, Due 6/10)	433	433	433
(Business Services)	Subordinated Debt (11.0%, Due 9/11 6/17)[6]	32,161	32,072	4,132
	Common Stock (174 shares)		82,818	
	Total Investment		**115,323**	**4,565**
	Guaranty ($900)			

(1) Interest rates represent the weighted average annual stated interest rate on loans and debt securities, which are presented by nature of indebtedness for a single issuer. The maturity dates represent the earliest and the latest maturity dates.

(2) Common stock, preferred stock, warrants, options, and equity interests are generally non-income producing and restricted.

(5) Non-registered investment company.
(6) Loan or debt security is on non-accrual status and therefore is considered non-income producing.
(8) Crescent Equity Corp. holds investments in Crescent Hotels & Resorts, LLC and affiliates.

The accompanying notes are an integral part of these consolidated financial statements.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

Private Finance Portfolio Company (in thousands, except number of shares)	**Investment[1][2]**	**December 31, 2009 Principal**	**Cost**	**Value**
Direct Capital Corporation	Senior Loan (8.0%, Due 1/14)[6]	$ 8,175	$ 8,175	$ 8,744
(Financial Services)	Subordinated Debt (16.0%, Due 3/13)[6]	55,671	55,496	6,797
	Common Stock (2,317,020 shares)		25,732	
	Total Investment		**89,403**	**15,541**
Financial Pacific Company	Subordinated Debt (17.4%, Due 2/12 8/12)	68,967	68,880	34,780
(Financial Services)	Preferred Stock (9,458 shares)		8,865	
	Common Stock (12,711 shares)		12,783	
	Total Investment		**90,528**	**34,780**
HCI Equity, LLC[4][5]	Equity Interests		1,100	877
(Private Equity Fund)				
	Total Investment		**1,100**	**877**
Hot Light Brands, Inc.	Senior Loan (9.0%, Due 2/11)[6]	29,257	29,257	9,116
(Real Estate)	Common Stock (93,500 shares)		5,151	
	Total Investment		**34,408**	**9,116**
Hot Stuff Foods, LLC	Senior Loan (3.7%, Due 2/12)	44,697	44,602	44,697
(Consumer Products)	Subordinated Debt (12.3%, Due 8/12-2/13)[6]	83,692	83,387	48,240
	Common Stock (1,147,453 shares)		56,187	
	Total Investment		**184,176**	**92,937**
Huddle House, Inc.	Subordinated Debt (15.0%, Due 12/15)	19,694	19,646	19,646
(Retail)			36,348	3,919

	Common Stock (358,428 shares)			
	Total Investment		**55,994**	**23,565**
IAT Equity, LLC and Affiliates	Subordinated Debt (9.0%, Due 6/14)	6,000	6,000	6,000
d/b/a Industrial Air Tool	Equity Interests		7,500	5,485
(Industrial Products)	**Total Investment**		**13,500**	**11,485**
Impact Innovations Group, LLC	Equity Interests in Affiliate			215
(Business Services)	**Total Investment**			**215**
Insight Pharmaceuticals Corporation	Subordinated Debt (15.0%, Due 9/12)	54,443	54,385	54,023
(Consumer Products)	Common Stock (155,000 shares)		40,413	9,400
	Total Investment		**94,798**	**63,423**
Jakel, Inc.	Subordinated Debt (15.5%, Due 3/08)(6)	748	748	
(Industrial Products)	**Total Investment**		**748**	
Knightsbridge CLO 2007-1 Ltd.(4) (CLO)	Class E Notes (9.3%, Due 1/22)	18,700	18,700	11,360
	Income Notes (4.4%)(7)		39,174	16,220
	Total Investment		**57,874**	**27,580**

(1) Interest rates represent the weighted average annual stated interest rate on loans and debt securities, which are presented by nature of indebtedness for a single issuer. The maturity dates represent the earliest and the latest maturity dates.

(2) Common stock, preferred stock, warrants, options, and equity interests are generally non-income producing and restricted.

(4) Non-U.S. company or principal place of business outside the U.S.

(5) Non-registered investment company.

(6) Loan or debt security is on non-accrual status and therefore is considered non-income producing.

(7) Represents the effective interest yield earned on the cost basis of these preferred equity investments and income notes. The yield is included in interest income in the consolidated statement of operations.

The accompanying notes are an integral part of these consolidated financial statements.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

Private Finance Portfolio Company (in thousands, except number of shares)	**Investment[1][2]**	**December 31, 2009 Principal**	**Cost**	**Value**
Knightsbridge CLO 2008-1 Ltd.[4]	Class C Notes (7.8%, Due 6/18)	$ 12,800	$ 12,800	$ 12,289
(CLO)	Class D Notes (8.8%, Due 6/18)	8,000	8,000	7,160
	Class E Notes (5.3%, Due 6/18)	13,200	11,291	10,091
	Income Notes (20.8%)[7]		21,893	20,637
	Total Investment		**53,984**	**50,177**
MVL Group, Inc.	Senior Loan (12.0%, Due 7/12)	25,260	25,256	25,260
(Business Services)	Subordinated Debt (14.5%, Due 7/12)	35,607	35,578	34,306
	Subordinated Debt (8.0%, Due 7/12)[6]	144	139	
	Common Stock (560,716 shares)		555	
	Total Investment		**61,528**	**59,566**
Penn Detroit Diesel Allison, LLC	Equity Interests		20,081	15,258
(Business Services)	**Total Investment**		**20,081**	**15,258**
Service Champ, Inc.	Subordinated Debt (15.5%, Due 4/12)	27,742	27,696	27,696
(Business Services)	Common Stock (55,112 shares)		11,145	28,071
	Total Investment		**38,841**	**55,767**
Stag-Parkway, Inc.	Subordinated Debt (10.0%, Due 7/12)	19,044	19,004	19,004
(Business Services)	Common Stock (25,000 shares)		32,686	14,226

	Total Investment		**51,690**	**33,230**
Startec Equity, LLC	Equity Interests		211	65
(Telecommunications)	**Total Investment**		**211**	**65**
Total companies more than 25% owned			**$ 1,747,759**	**$ 811,736**
Companies 5% to 25% Owned				
10th Street, LLC	Subordinated Debt (13.0%, Due 11/14)	$ 22,325	$ 22,234	$ 22,325
(Business Services)	Equity Interests		422	475
	Option		25	25
	Total Investment		**22,681**	**22,825**
Air Medical Group Holdings LLC	Senior Loan (2.8%, Due 3/11)	6,075	6,056	5,845
(Healthcare Services)	Equity Interests		2,993	19,500
	Total Investment		**9,049**	**25,345**
BB&T Capital Partners/Windsor Mezzanine Fund, LLC(5)	Equity Interests		11,789	10,379
(Private Equity Fund)	**Total Investment**		**11,789**	**10,379**
Driven Brands, Inc.	Subordinated Debt (16.6%, Due 7/15)	91,991	91,647	91,899
(Consumer Services)	Common Stock (3,772,098 shares)		9,516	3,000
	Total Investment		**101,163**	**94,899**

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(7)

Represents the effective interest yield earned on the cost basis of these preferred equity investments and income notes. The yield is included in interest income in the consolidated statement of operations.

The accompanying notes are an integral part of these consolidated financial statements.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

Private Finance Portfolio Company (in thousands, except number of shares)	**Investment[1][2]**	**December 31, 2009 Principal**	**Cost**	**Value**
Multi-Ad Services, Inc.	Unitranche Debt (11.3%, Due 11/11)	$ 2,500	$ 2,485	$ 2,491
(Business Services)	Equity Interests		1,737	1,418
	Total Investment		**4,222**	**3,909**
Pendum Acquisition, Inc.	Common Stock (8,872 shares)			200
(Business Services)	**Total Investment**			**200**
Postle Aluminum Company, LLC	Senior Loan (6.0%, Due 10/12)[6]	35,000	34,876	16,054
(Industrial Products)	Subordinated Debt (3.0%, Due 10/12)[6]	23,953	23,868	
	Equity Interests		2,174	
	Total Investment		**60,918**	**16,054**
Regency Healthcare Group, LLC (Healthcare Services)	Equity Interests		1,302	1,898
	Total Investment		**1,302**	**1,898**