ALLIED CAPITAL CORP
Form N-2/A
June 01, 2007

As filed with the Securities and Exchange Commission on June 1, 2007

Registration No. 333-141848

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM N-2

REGISTRATION STATEMENT

UNDER
THE SECURITIES ACT OF 1933

þ **Pre-Effective Amendment No. 1**
o **Post-Effective Amendment No.**

ALLIED CAPITAL CORPORATION

(Exact Name of Registrant as Specified in Charter)

1919 Pennsylvania Avenue, N.W.

Washington, D.C. 20006-3434
(202) 721-6100
(Address and Telephone Number, including Area Code, of Principal Executive Offices)

William L. Walton, Chairman and Chief Executive Officer

Allied Capital Corporation
1919 Pennsylvania Avenue, N.W.
Washington, D.C. 20006-3434
(Name and Address of Agent for Service)

Copies of information to:

Cynthia M. Krus, Esq.
Steven B. Boehm, Esq.
Sutherland Asbill & Brennan LLP
1275 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-2415

Approximate Date of Proposed Public Offering:

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

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

CALCULATION OF REGISTRATION FEE UNDER THE SECURITIES ACT OF 1933

Title of Securities Being Registered	Amount Being Registered[(1)]	Proposed Maximum Offering Price Per Share[(2)]	Proposed Maximum Aggregate Offering Price	Amount of Registration Fee[(3)]
Common Stock, $0.0001 par value per share	21,202,500 shares	$28.78	$610,207,950	$18,734

(1) In reliance upon Rule 429 under the Securities Act of 1933, this amount is in addition to the securities previously registered by the Registrant under a registration statement on Form N-2 (File No. 333-132515). All securities unsold under the prospectus contained in such prior Registration Statement (a total of 28,797,500 shares of common stock) are carried forward into this Registration Statement, and the prospectus contained as a part of this Registration Statement shall be deemed to be combined with the prospectus contained in the above-referenced registration statement, which has previously been filed.

(2) Estimated solely for the purpose of calculating the registration fee pursuant to Rule 457(c) under the Securities Act of 1933 on the basis of the average of the high and low sales prices of the common stock on April 2, 2007, as reported on the New York Stock Exchange.

(3) Previously paid.

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

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

PROSPECTUS (Subject to Completion)
, 2007

50,000,000 Shares

Common Stock

We may offer, from time to time, up to 50,000,000 shares of our common stock in one or more offerings.

The shares of common stock may be offered at prices and on terms to be described in one or more supplements to this prospectus. The offering price per share of our common stock less any underwriting commissions or discounts will not be less than the net asset value per share of our common stock at the time we make the offering.

We are an internally managed closed-end, non-diversified management investment company that has elected to be regulated as a business development company under the Investment Company Act of 1940.

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

Please read this prospectus and the accompanying prospectus supplement, if any, before investing, and keep it for future reference. The prospectus and the accompanying prospectus supplement contain important information about us that a prospective investor should know before investing in our common stock. We file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission. This information is available free of charge by contacting us at 1919 Pennsylvania Avenue, N.W., Washington, DC, 20006 or by telephone at (202) 721-6100 or on our website at www.alliedcapital.com. The SEC also maintains a website at www.sec.gov that contains such information.

Our common stock is traded on the New York Stock Exchange under the symbol ALD. As of May 30, 2007, the last reported sale price on the New York Stock Exchange for the common stock was $31.66.

You should review the information, including the risk of leverage, set forth under Risk Factors on page 10 of this prospectus before investing in our common stock.

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

This prospectus may not be used to consummate sales of shares of common stock unless accompanied by a prospectus supplement.

June , 2007

We have not authorized any dealer, salesman or other person to give any information or to make any representation other than those contained in this prospectus or any prospectus supplement, if any, to this prospectus. You must not rely upon any information or representation not contained in this prospectus or any such supplements as if we had authorized it. This prospectus and any such supplements do not constitute an offer to sell or a solicitation of any offer to buy any security other than the registered securities to which they relate, nor do they constitute an offer to sell or a solicitation of an offer to buy any securities in any jurisdiction to any person to whom it is unlawful to make such an offer or solicitation in such jurisdiction. The information contained in this prospectus and any such supplements is accurate as of the dates on their covers; however, the prospectus and any supplements will be updated to reflect any material changes.

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ABOUT THIS PROSPECTUS

This prospectus is part of a registration statement that we have filed with the Securities and Exchange Commission using the shelf registration process. Under the shelf registration process, which constitutes a delayed offering in reliance on Rule 415 under the Securities Act of 1933, as amended, we may offer, from time to time, up to 50,000,000 shares of our common stock on the terms to be determined at the time of the offering. Shares of our common stock may be offered at prices and on terms described in one or more

supplements to this prospectus. This prospectus provides you with a general description of the shares of our common stock that we may offer. Each time we use this prospectus to offer shares of our common stock, we will provide a prospectus supplement that will contain specific information about the terms of that offering. A prospectus supplement may also add, update or change information contained in this prospectus. Please carefully read this prospectus and any such supplements together with the additional information described under Where You Can Find Additional Information in the Prospectus Summary and Risk Factors sections before you make an investment decision.

A prospectus supplement may also add to, update or change information contained in this prospectus.

PROSPECTUS SUMMARY

The following summary contains basic information about this offering. It may not contain all the information that is important to an investor. For a more complete understanding of this offering, we encourage you to read this entire prospectus and the documents that are referred to in this prospectus, together with any accompanying supplements.

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

BUSINESS *(Page 79)*

We are a business development company in the private equity business and we are internally managed. We provide long-term debt and equity capital to primarily private middle market companies in a variety of industries. We have participated in the private equity business since we were founded in 1958 and have financed thousands of companies nationwide. Our investment objective is to achieve current income and capital gains.

We believe the private equity capital markets are important to the growth of small and middle market companies because such companies often have difficulty accessing the public debt and equity capital markets. We use the term middle market to include companies with annual revenues typically between $50 million and $500 million. We believe that we are well positioned to be a source of capital for such companies.

We primarily invest in the American entrepreneurial economy. At March 31, 2007, our private finance portfolio included investments in 144 companies that generate aggregate annual revenues of over $13 billion and employ more than 90,000 people.

We generally target companies in less cyclical industries with, among other things, high returns on invested capital, management teams with meaningful equity ownership, well-constructed balance sheets, and the ability to generate free cash flow. As a private equity investor, we spend significant time and effort identifying, structuring, performing due diligence, monitoring, developing, valuing, and ultimately exiting our investments.

Our investment activity is primarily focused on making long-term investments in the debt and equity of primarily private middle market companies. Debt investments may include senior loans, unitranche debt (a single debt investment that is a blend of senior and subordinated debt terms), or subordinated debt (with or without equity features). Equity investments may include a minority equity stake in connection with a debt investment or a substantial equity stake in connection with a buyout transaction. In a buyout transaction, we generally invest in senior debt, subordinated debt and equity (preferred and/or voting or non-voting common) where our equity ownership represents a significant portion of the equity, but may or may not represent a controlling interest.

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

The capital we provide is used by portfolio companies to fund buyouts, acquisitions, growth, recapitalizations, note purchases, or other types of financings.

Our investments are typically structured to provide recurring cash flow in the form of interest income to us as the investor. In addition to earning interest income, we may structure our investments to generate income from management, consulting, diligence, structuring, or other fees. We may also enhance our total return from capital gains through equity features, such as nominal cost warrants, or by investing in equity investments.

We provide managerial assistance to our portfolio companies, including, but 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.

We have elected to be taxed as a regulated investment company under Subchapter M of the Internal Revenue Code of 1986, otherwise referred to as the Code. Assuming that we qualify as a regulated investment company, we generally will not be subject to corporate level income taxation on income we timely distribute to our stockholders as dividends. See Tax Status. We pay regular quarterly dividends based upon an estimate of annual taxable income available for distribution to shareholders and the amount of taxable income carried over from the prior year for distribution in the current year. Since 1963, our portfolio has provided sufficient ordinary taxable income and realized net capital gains to sustain or grow our dividends over time.

We are a Maryland corporation and a closed-end, non-diversified management investment company that has elected to be regulated as a business development company under the Investment Company Act of 1940, which we refer to as the 1940 Act.

As a business development company, we are required to meet certain regulatory tests, the most significant relating to our investments and borrowings. A business development company is required to invest at least 70% of its assets in eligible portfolio companies. A business development company must also maintain a coverage ratio of assets to senior securities of at least 200%. See Certain Government Regulations and Risk Factors.

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

Our Internet website address is *www.alliedcapital.com.* Information contained on our website is not incorporated by reference into this prospectus and you should not consider information contained on our website to be part of this prospectus.

Our common stock is traded on the New York Stock Exchange under the symbol ALD.

DETERMINATION OF

NET ASSET VALUE *(Page 104)*

Our portfolio investments are generally recorded at fair value as determined in good faith by our Board of Directors in the absence of readily available public market values.

Pursuant to the requirements of the 1940 Act, we value substantially all of our portfolio investments at fair value as determined in good faith by the Board of Directors on

a quarterly basis. Since there is typically no readily available market value for the investments in our portfolio, our Board of Directors determines in good faith the fair value of these portfolio investments pursuant to our valuation policy and consistently applied valuation process.

There is no single standard for determining fair value in good faith. As a result, determining fair value requires that judgment be applied to the specific facts and circumstances of each portfolio investment while employing a consistently applied valuation process for the types of investments we make. Unlike banks, we are not permitted to provide a general reserve for anticipated loan losses. Instead, we are required to specifically value each individual investment on a quarterly basis. We will record unrealized depreciation on investments when we believe that an investment has become impaired, including where collection of a loan or realization of an equity security is doubtful, or when the enterprise value of the portfolio company does not currently support the cost of our debt or equity investment. Enterprise value means the entire value of the company to a potential buyer, including the sum of the values of debt and equity securities used to capitalize the enterprise at a point in time. We will record unrealized appreciation if we believe that the underlying portfolio company has appreciated in value and/or our equity security has appreciated in value. Without a readily available market value and because of the inherent uncertainty of valuation, the fair value of our investments determined in good faith by the Board of Directors may differ significantly from the values that would have been used had a ready market existed for the investments, and the differences could be material.

We adjust the valuation of our portfolio quarterly to reflect the change in the value of each investment in our portfolio. Any changes in value are recorded in our statement of operations as net change in unrealized appreciation or depreciation.

PLAN OF DISTRIBUTION *(Page 161)*

We may offer, from time to time, up to 50,000,000 shares of our common stock, on terms to be determined at the time of the offering.

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

Our shares of common stock may be offered directly to one or more purchasers, through agents designated from time to time by us, or to or through underwriters or dealers. The supplement to this prospectus relating to the offering will identify any agents or underwriters involved in the sale of our shares of common stock, and will set forth any applicable purchase price, fee and commission or discount arrangement or the basis upon which such amount may be calculated.

We may not sell shares of common stock pursuant to this prospectus without delivering a prospectus supplement describing the method and terms of the offering of such shares.

USE OF PROCEEDS *(Page 19)*

We intend to use the net proceeds from selling shares of common stock for general corporate purposes, which includes investing in debt or equity securities in primarily privately negotiated transactions, repayment of indebtedness, acquisitions and other general corporate purposes.

Any supplement to this prospectus relating to any offering of common stock will more fully identify the use of the proceeds from such offering.

PRICE RANGE OF COMMON STOCK AND DISTRIBUTIONS *(Page 20)*

We intend to pay quarterly dividends to holders of our common stock. The amount of our quarterly dividends is determined by our Board of Directors on a quarterly basis.

DIVIDEND REINVESTMENT PLAN *(Page 151)*

We maintain an opt in dividend reinvestment plan for our common shareholders. As a result, if our Board of Directors declares a dividend, then our shareholders that have not opted in to our dividend reinvestment plan will receive cash dividends. New shareholders must notify our transfer agent in writing if they wish to enroll in the dividend reinvestment plan.

RISK FACTORS *(Page 10)*

Investment in shares of our common stock involves a number of significant risks relating to our business and our investment objective that you should consider before purchasing shares of our common stock.

Our portfolio of investments is generally illiquid. Our portfolio includes securities primarily issued by private companies. These investments may involve a high degree of business and financial risk; they are illiquid, and may not produce current returns or capital gains. If we were forced to immediately liquidate some or all of the investments in the portfolio, the proceeds of such liquidation could be significantly less than the current value of such investments. We may be required to liquidate some or all of our portfolio investments to meet our debt service obligations or in the event we are required to fulfill our obligations under agreements pursuant to which we guarantee the repayment of indebtedness by third parties.

An economic slowdown may affect the ability of a portfolio company to engage in a liquidity event, which is a transaction that involves the sale or recapitalization of all or part of a portfolio company. These conditions could lead to financial losses in our portfolio and a decrease in our revenues, net income and assets. Numerous other factors may affect a borrower s ability to repay its loan, including the failure to meet its business plan, a downturn in its industry or negative economic conditions.

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

We may not borrow money unless we maintain asset coverage for indebtedness of at least 200%, which may affect returns to shareholders. We borrow funds to make

investments. As a result, we are exposed to the risks of leverage, which may be considered a speculative investment technique. Borrowings, also known as leverage, magnify the potential for gain and loss on amounts invested and therefore increase the risks associated with investing in our securities.

A large number of entities and individuals compete for the same kind of investment opportunities as we do. Increased competition would make it more difficult for us to purchase or originate investments at attractive prices. As a result of this competition, sometimes we may be precluded from making otherwise attractive investments.

Our business of making private equity investments and positioning them for liquidity events also may be affected by current and future market conditions.

To maintain our status as a business development company, we must not acquire any assets other than qualifying assets unless, at the time of and after giving effect to such acquisition, at least 70% of our total assets are qualifying assets.

We may not be able to pay dividends and failure to qualify as a regulated investment company for tax purposes could have a material adverse effect on the income available for debt service or distributions to our shareholders, which may have a material adverse effect on our total return to common shareholders, if any.

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

Our common stock price may be volatile due to market factors that may be beyond our control.

CERTAIN ANTI-TAKEOVER PROVISIONS *(Page 154)*

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

FEES AND EXPENSES

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

Shareholder Transaction Expenses	
Sales load (as a percentage of offering price)[1]	%
Dividend reinvestment plan fees[2]	None
Annual Expenses (as a percentage of consolidated net assets attributable to common stock)(3)	
Operating expenses[4]	5.52%
Interest payments on borrowed funds[5]	4.67%
Acquired fund fees and expenses[6]	%
Total annual expenses[7][8]	10.19%

Example

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

	1 Year	3 Years	5 Years	10 Years
You would pay the following expenses on a $1,000 investment, assuming a 5.0% annual return	$101	$301	$496	$965

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

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

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

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

(3) Consolidated net assets attributable to common stock equals net assets (*i.e.*, total consolidated assets less total consolidated liabilities), which at March 31, 2007, was $3.0 billion.

(4) Operating expenses represent our estimated operating expenses for the year ending December 31, 2007, excluding interest on indebtedness. This percentage for the year ended December 31, 2006, was 5.19%. See Management s Discussion and Analysis of Financial Condition and Results of Operations, Management and Compensation of Executive Officers and Directors.

(5) The Interest payments on borrowed funds represents our estimated interest expense for the year ending December 31, 2007, including estimated interest related to usage under our revolving line of credit and new debt issuances that we anticipate during the remainder of 2007.

We had outstanding borrowings of $1.9 billion at March 31, 2007. See Risk Factors. This percentage for the year ended December 31, 2006, was 3.54%.

(6) See our Consolidated Statement of Investments as of March 31, 2007, on pages F-75 through F-85 for our investments in funds.

(7) Total annual expenses as a percentage of consolidated net assets attributable to common stock are higher than the total annual expenses percentage would be for a company that is not leveraged. We borrow money to leverage our net assets and increase our total assets. The SEC requires that Total annual expenses percentage be calculated as a percentage of *net* assets, rather than the total assets, including assets that have been funded with borrowed monies. If the Total annual expenses percentage were calculated instead as a percentage of consolidated total assets, our Total annual expenses would be 6.09% of consolidated total assets.

(8) The holders of shares of our common stock (and not the holders of our debt securities or preferred stock, if any) indirectly bear the cost associated with our annual expenses.

SELECTED CONDENSED CONSOLIDATED FINANCIAL DATA

You should read the condensed consolidated financial information below with the Consolidated Financial Statements and Notes thereto included herein. Financial information at and for the years ended December 31, 2006, 2005, 2004, 2003, and 2002, has been derived from our financial statements that were audited by KPMG LLP. Quarterly financial information is derived from unaudited financial data, but in the opinion of management, reflects all adjustments (consisting only of normal recurring adjustments) which are necessary to present fairly the results for such interim periods. Interim results at and for the three months ended March 31, 2007, are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. **See Management s Discussion and Analysis of Financial Condition and Results of Operations and Senior Securities below for more information.**

(in thousands, except per share data)	At and for the Three Months Ended March 31,	At and for the Year Ended December 31,				
	2007	2006	2005	2004	2003	2002
	(unaudited)					
Operating Data:						
Interest and related portfolio income:						
Interest and dividends	$101,983	$ 386,427	$317,153	$319,642	$290,719	$264,042
Fees and other income	5,969	66,131	56,999	47,448	38,510	45,886
Total interest and related portfolio income	107,952	452,558	374,152	367,090	329,229	309,928
Expenses:						
Interest	30,288	100,600	77,352	75,650	77,233	70,443
Employee	21,928	92,902	78,300	53,739	36,945	33,126
Employee stock options[1]	3,661	15,599				
Administrative	13,224	39,005	69,713	34,686	22,387	21,504
Total operating expenses	69,101	248,106	225,365	164,075	136,565	125,073
Net investment income before income taxes	38,851	204,452	148,787	203,015	192,664	184,855
Income tax expense (benefit), including excise tax	(649)	15,221	11,561	2,057	(2,466)	930
Net investment income	39,500	189,231	137,226	200,958	195,130	183,925
Net realized and unrealized gains (losses):						
Net realized gains	27,666	533,301	273,496	117,240	75,347	44,937
Net change in unrealized appreciation or depreciation	65,920	(477,409)	462,092	(68,712)	(78,466)	(571)
Total net gains (losses)	93,586	55,892	735,588	48,528	(3,119)	44,366
Net increase in net assets resulting from operations	$133,086	$ 245,123	$872,814	$249,486	$192,011	$228,291
Per Share:						
Diluted earnings per common share	$ 0.87	$ 1.68	$ 6.36	$ 1.88	$ 1.62	$ 2.20
Net investment income plus net realized gains per share[2]	$ 0.44	$ 4.96	$ 2.99	$ 2.40	$ 2.28	$ 2.21

Dividends per common share[2]	$ 0.63	$ 2.47	$ 2.33	$ 2.30	$ 2.28	$ 2.23
Weighted average common shares outstanding diluted	152,827	145,599	137,274	132,458	118,351	103,574

(in thousands, except per share data)	At and for the Three Months Ended March 31, 2007 (unaudited)	At and for the Year Ended December 31, 2006	2005	2004	2003	2002
Balance Sheet Data:						
Portfolio at value	$4,498,848	$4,496,084	$3,606,355	$3,013,411	$2,584,599	$2,488,167
Total assets	4,986,076	4,887,505	4,025,880	3,260,998	3,019,870	2,794,319
Total debt outstanding(3)	1,891,516	1,899,144	1,284,790	1,176,568	954,200	998,450
Undistributed (distributions in excess of) earnings	473,576	502,163	112,252	12,084	(13,401)	(15,830)
Shareholders equity	2,978,277	2,841,244	2,620,546	1,979,778	1,914,577	1,546,071
Shareholders equity per common share (net asset value)(4)	$ 19.58	$ 19.12	$ 19.17	$ 14.87	$ 14.94	$ 14.22
Common shares outstanding at end of year	152,124	148,575	136,697	133,099	128,118	108,698
Asset coverage ratio(5)	257%	250%	309%	280%	322%	270%
Debt to equity ratio	0.64	0.67	0.49	0.59	0.50	0.65
Other Data:						
Investments funded	$ 170,216	$2,437,828	$1,675,773	$1,524,523	$ 931,450	$ 506,376
Principal collections related to investment repayments or sales	235,509	1,055,347	1,503,388	909,189	788,328	356,641
Realized gains	33,181	557,470	343,061	267,702	94,305	95,562
Realized losses	(5,515)	(24,169)	(69,565)	(150,462)	(18,958)	(50,625)

(in thousands, except per share data)	2007 Qtr 1	2006 Qtr 4	2006 Qtr 3	2006 Qtr 2	2006 Qtr 1	2005 Qtr 4	2005 Qtr 3	2005 Qtr 2	2005 Qtr 1
Quarterly Data (unaudited):									
Total interest and related portfolio income	$107,952	$117,708	$113,383	$110,456	$111,011	$ 98,169	$ 94,857	$ 86,207	$ 94,919
Net investment income	39,500	49,078	48,658	50,195	41,300	37,073	46,134	15,267	38,752
Net increase in net assets resulting from operations	133,086	33,921	77,886	33,729	99,587	328,140	113,168	311,885	119,621
Diluted earnings per common share	0.87	0.23	0.53	0.24	0.70	2.36	0.82	2.29	0.88
Dividends declared per common share(6)	0.63	0.67	0.61	0.60	0.59	0.61	0.58	0.57	0.57
Net asset value per common share(4)	19.58	19.12	19.38	19.17	19.50	19.17	17.37	17.01	15.22

(1) Effective January 1, 2006, we adopted the provisions of Statement No. 123 (Revised 2004), *Share-Based Payment*. See 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 are the most significant components of our annual taxable income from which dividends are paid. At December 31, 2006, we had estimated excess taxable income of $397.1 million carried over for distribution to shareholders in 2007. See Management s Discussion and Analysis of Financial Condition and Results of Operations and Dividends and Distributions below.

(3) See Senior Securities and 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) As a business development company, we are generally required to maintain a minimum ratio of 200% of total assets to total borrowings.

(6) Dividends declared per common share for the fourth quarter of 2006 included the regular quarterly dividend of $0.62 per common share and an extra dividend of $0.05 per common share. Dividends declared per common share for the fourth quarter of 2005 included the regular quarterly dividend of $0.58 per common share and an extra dividend of $0.03 per common share.

8

WHERE YOU CAN FIND

ADDITIONAL INFORMATION

We have filed with the SEC a registration statement on Form N-2 together with all amendments and related exhibits under the Securities Act of 1933. The registration statement contains additional information about us and the securities being offered by this prospectus.

We file annual, quarterly and current reports, proxy statements and other information with the SEC under the Securities Exchange Act of 1934. You can inspect any materials we file with the SEC, without charge, at the SEC s Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the Public Reference Room. The information we file with the SEC is available free of charge by contacting us at 1919 Pennsylvania Avenue, N.W., Washington, DC, 20006-3434, or by telephone at (202) 721-6100 or on our website at www.alliedcapital.com. The SEC also maintains a website that contains reports, proxy statements and other information regarding registrants, including us, that file such information electronically with the SEC. The address of the SEC s website is *www.sec.gov*. Information contained on our website or on the SEC s website about us is not incorporated into this prospectus and you should not consider information contained on our website or on the SEC s website to be part of this prospectus.

RISK FACTORS

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

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

Investing in private companies involves a high degree of risk. Our portfolio primarily consists of long-term loans to and investments in middle market private companies. Investments in private businesses involve a high degree of business and financial risk, which can result in substantial losses for us in those investments and accordingly should be considered speculative. There is generally no publicly available information about the companies in which we invest, and we rely significantly on the diligence of our employees and agents to obtain information in connection with our investment decisions. If we are unable to identify all material information about these companies, among other factors, we may fail to receive the expected return on our investment or lose some or all of the money invested in these companies. In addition, these businesses may have shorter operating histories, narrower product lines, smaller market shares and less experienced management than their competition and may be more vulnerable to customer preferences, market conditions, loss of key personnel, or economic downturns, which may adversely affect the return on, or the recovery of, our investment in such businesses. As an investor, we are subject to the risk that a portfolio company may make a business decision that does not serve our interest, which could decrease the value of our investment. Deterioration in a portfolio company s financial condition and prospects may be accompanied by deterioration in any collateral for the loan.

Substantially all of our portfolio investments are recorded at fair value as determined in good faith by our Board of Directors and, as a result, there is uncertainty regarding the value of our portfolio investments. At March 31, 2007, portfolio investments recorded at fair value were 90% of our total assets. Pursuant to the requirements of the 1940 Act, we value substantially all of our investments at fair value as determined in good faith by our Board of Directors on a quarterly basis. Since there is typically no readily available market value for the investments in our portfolio, our Board of Directors determines in good faith the fair value of these investments pursuant to a valuation policy and a consistently applied valuation process.

There is no single standard for determining fair value in good faith. As a result, determining fair value requires that judgment be applied to the specific facts and circumstances of each portfolio investment while employing a consistently applied valuation process for the types of investments we make. In determining fair value in good faith, we generally obtain financial and other information from portfolio companies, which may represent unaudited, projected or proforma 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 and record unrealized depreciation for an investment that we believe has become impaired, including where collection of a loan or realization of an equity security is doubtful, or when the enterprise value of the portfolio company does not currently support the cost of our debt or equity investment. Enterprise value means the entire value of the company to a potential buyer, including the sum of the values of debt and equity securities used to capitalize the enterprise at a point in time. We will record unrealized appreciation if we believe that the underlying portfolio company has appreciated in value and/or our equity security has appreciated in value. Without a readily available market value and because of the inherent uncertainty of valuation, the fair value of our investments determined in good faith by the Board of Directors may differ significantly from the values that would have been used had a ready market existed for the investments, and the differences could be material. Our net asset value could be affected if our determination of the fair value of our investments is materially different than the value that we ultimately realize.

We adjust quarterly the valuation of our portfolio to reflect the Board of Directors determination of the fair value of each investment in our portfolio. Any changes in fair value are recorded in our statement of operations as net change in unrealized appreciation or depreciation.

Economic recessions or downturns could impair our portfolio companies and harm our operating results. Many of the companies in which we have made or will make investments may be susceptible to economic slowdowns or recessions. An economic slowdown may affect the ability of a company to repay our loans or engage in a liquidity event such as a sale, recapitalization, or initial public offering. Our nonperforming assets are likely to increase and the value of our portfolio is likely to decrease during these periods. Adverse economic conditions also may decrease the value of any collateral securing some of our loans. These conditions could lead to financial losses in our portfolio and a decrease in our revenues, net income, and assets.

Our business of making private equity investments and positioning them for liquidity events also may be affected by current and future market conditions. The absence of an active senior lending environment or a slowdown in middle market merger and acquisition activity may slow the amount of private equity investment activity generally. As a result, the pace of our investment activity may slow. In addition, significant changes in the capital markets could have an effect on the valuations of private companies and on the potential for liquidity events involving such companies. This could affect the timing of exit events in our portfolio and could negatively affect the amount of gains or losses upon exit.

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

senior to or equally with our securities. This means that payments on such senior-ranking securities may have to be made before we receive any payments on our 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 investments are typically structured as unsecured debt securities with a relatively high fixed rate of interest and with equity features such as conversion rights, warrants, or options, or as buyouts of companies where we invest in debt and equity securities. As a result, our private finance investments are generally structured to generate interest income from the time they are made and may also produce a realized gain from an accompanying equity feature. We cannot be sure that our portfolio will generate a current return or capital gains.

Our financial results could be negatively affected if a significant portfolio investment fails to perform as expected. Our total investment in companies may be significant individually or in the aggregate. As a result, if a significant investment in one or more companies fails to perform as expected, our financial results could be more negatively affected and the magnitude of the loss could be more significant than if we had made smaller investments in more companies. At March 31, 2007, our largest investments at value were in Mercury Air Centers, Inc. and Business Loan Express, LLC (BLX), which represented 6.0% and 4.6% of our total assets, respectively, and 2.0% and 1.3% of our total interest and related portfolio income, respectively, for the three months ended March 31, 2007. See Management s Discussion and Analysis of Financial Condition and Results of Operations Private Finance.

BLX is a national, non-bank lender that participates in the Small Business Administration s (SBA) 7(a) Guaranteed Loan Program and is licensed by the SBA as a Small Business Lending Company (SBLC). The Office of the Inspector General of the SBA (OIG) and the United States Secret Service are conducting an ongoing investigation of allegedly fraudulently obtained SBA-guaranteed loans issued by BLX. The OIG and the U.S. Department of Justice are also conducting a civil investigation of BLX s lending practices in various jurisdictions. These investigations are ongoing. As an SBA lender, BLX is also subject to other SBA and OIG audits, investigations, and reviews. These investigations, audits and reviews, related litigation, changes in the laws or regulations that govern SBLCs or the SBA 7(a) Guaranteed Loan Program, or changes in government funding for this program could have a material adverse impact on BLX and, as a result, could negatively affect our financial results. See Management s Discussion and Analysis of Financial Condition and Results of Operations Private Finance, Business Loan Express, LLC.

We borrow money, which magnifies the potential for gain or loss on amounts invested and may increase the risk of investing in us. Borrowings, also known as leverage, magnify the potential for gain or loss on amounts invested and, therefore, increase the risks associated with investing in our securities. We borrow from and issue senior debt securities to banks, insurance companies, and other lenders or investors. Holders of these senior securities have fixed dollar claims on our consolidated assets that are superior to the claims of our common shareholders. If the value of our consolidated assets increases, then leveraging would cause the net asset value attributable to our common stock to increase more sharply than it would have had we not leveraged. Conversely, if the value of our consolidated assets decreases, leveraging would cause net asset value to decline more

sharply than it otherwise would have had we not leveraged. Similarly, any increase in our consolidated income in excess of consolidated interest payable on the borrowed funds would cause our net income to increase more than it would without the leverage, while any decrease in our consolidated income would cause net income to decline more sharply than it would have had we not borrowed. Such a decline could negatively affect our ability to make common stock dividend payments. Leverage is generally considered a speculative investment technique. We and, indirectly, our stockholders will bear the cost associated with our leverage activity. Our revolving line of credit and notes payable contain financial and operating covenants that could restrict our business activities, including our ability to declare dividends if we default under certain provisions. 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 March 31, 2007, we had $1.9 billion of outstanding indebtedness bearing a weighted average annual interest cost of 6.5% and a debt to equity ratio of 0.64 to 1.00. We may incur additional debt in the future. 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 have achieved annual returns on our assets of at least 2.5% as of March 31, 2007, which returns were achieved.

Illustration. The following table illustrates the effect of leverage on returns from an investment in our common stock assuming various annual returns, net of expenses. The calculations in the table below are hypothetical and actual returns may be higher or lower than those appearing below. The calculation assumes (i) $4,986.1 million in total assets, (ii) an average cost of funds of 6.5%, (iii) $1,891.5 million in debt outstanding and (iv) $2,978.3 million of shareholders equity.

Assumed Return on Our Portfolio

(net of expenses)

	-20%	**-10%**	**-5%**	**0%**	**5%**	**10%**	**20%**
Corresponding return to shareholder	-37.61%	-20.87%	-12.50%	-4.13%	4.24%	12.61%	29.35%

We may not borrow money unless we maintain asset coverage for indebtedness of at least 200%, which may affect returns to shareholders. Under the 1940 Act and the covenants applicable to our public debt, we must maintain asset coverage for total borrowings of at least 200%. Our ability to achieve our investment objective may depend in part on our continued ability to maintain a leveraged capital structure by borrowing from banks, insurance companies or other lenders or investors on favorable terms. There can be no assurance that we will be able to maintain such leverage. If asset coverage declines to less than 200%, we may be required to sell a portion of our investments when it is disadvantageous to do so. As of March 31, 2007, our asset coverage for senior indebtedness was 257%.

Changes in interest rates may affect our cost of capital and net investment income. Because we borrow money to make investments, our net investment income is dependent upon the difference between the rate at which we borrow funds and the rate at which we invest these funds. As a result, there can be no assurance that a significant change in market interest rates will not have a material adverse effect on our net investment income.

In periods of rising interest rates, our cost of funds would increase, which would reduce our net investment income. We use a combination of long-term and short-term borrowings and equity capital to finance our investing activities. We utilize our revolving line of credit as a means to bridge to long-term financing. Our long-term fixed-rate investments are financed primarily with long-term fixed-rate debt and equity. We may use interest rate risk management techniques in an effort to limit our exposure to interest rate fluctuations. Such techniques may include various interest rate hedging activities to the extent permitted by the 1940 Act. We have analyzed the potential impact of changes in interest rates on interest income net of interest expense.

Assuming that the balance sheet as of March 31, 2007, 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 1% over a one year horizon. Although management believes that this measure is indicative of our sensitivity to interest rate changes, it does not adjust for potential changes in credit quality, size and composition of the assets on the balance sheet and other business developments that could affect net increase in net assets resulting from operations, or net income. Accordingly, no assurances can be given that actual results would not differ materially from the potential outcome simulated by this estimate.

We will continue to need additional capital to grow because we must distribute our income. We will continue to need capital to fund growth in our investments. Historically, we have borrowed from financial institutions or other investors and have issued debt and equity securities to grow our portfolio. A reduction in the availability of new debt or equity capital could limit our ability to grow. We must distribute at least 90% of our investment company taxable income (as defined in the Code), which excludes realized net long-term capital gains, to our shareholders to maintain our eligibility for the tax benefits available to regulated investment companies. As a result, such earnings will not be available to fund investment originations. In addition, as a business development company, we are generally required to maintain a ratio of at least 200% of total assets to total borrowings, which may restrict our ability to borrow in certain circumstances. We intend to continue to borrow from financial institutions or other investors and issue additional debt and equity securities. If we fail to obtain funds from such sources or from other sources to fund our investments, it could limit our ability to grow, which could have a material adverse effect on the value of our debt securities or common stock.

Loss of regulated investment company tax treatment would substantially reduce net assets and income available for debt service and dividends. We have operated so as to qualify as a regulated investment company under Subchapter M of the Code. If we meet source of income, asset diversification, and distribution requirements, we generally will not be subject to corporate-level income taxation on income we timely distribute to our stockholders as dividends. We would cease to qualify for such tax treatment if we were unable to comply with these requirements. In addition, we may have difficulty meeting the requirement to make distributions to our stockholders because in certain cases we may recognize income before or without receiving cash representing such income. If we fail to qualify as a regulated investment company, we will have to pay corporate-level taxes on all of our income whether or not we distribute it, which would substantially reduce the amount of income available for debt service and distributions to our stockholders. Even if we qualify as a regulated investment company, we generally will be subject to a corporate-level income tax on the income we do not distribute. If we do not distribute at least 98% of our annual taxable income in the year earned, we generally will be required to pay an

excise tax on amounts carried over and distributed to shareholders in the next year equal to 4% of the amount by which 98% of our annual taxable income exceeds the distributions from such income for the current year.

There is a risk that our common stockholders may not receive dividends or distributions. We intend to make distributions on a quarterly basis to our stockholders. We may not be able to achieve operating results that will allow us to make distributions at a specific level or to increase the amount of these distributions from time to time. In addition, due to the asset coverage test applicable to us as a business development company, we may be limited in our ability to make distributions. Also, certain of our credit facilities limit our ability to declare dividends if we default under certain provisions. If we do not distribute a certain percentage of our income annually, we will suffer adverse tax consequences, including possible loss of the tax benefits available to us as a regulated investment company. In addition, in accordance with U.S. generally accepted accounting principles and tax regulations, we include in income certain amounts that we have not yet received in cash, such as contractual payment-in-kind interest, which represents contractual interest added to the loan balance that becomes due at the end of the loan term, or the accrual of original issue discount. The increases in loan balances as a result of contractual payment-in-kind arrangements are included in income in advance of receiving cash payment and are separately included in the change in accrued or reinvested interest and dividends in our consolidated statement of cash flows. Since we may recognize income before or without receiving cash representing such income, we may have difficulty meeting the requirement to distribute at least 90% of our investment company taxable income to obtain tax benefits as a regulated investment company.

We operate in a competitive market for investment opportunities. We compete for investments with a large number of private equity funds and mezzanine funds, other business development companies, investment banks, other equity and non-equity based investment funds, and other sources of financing, including specialty finance companies and traditional financial services companies such as commercial banks. Some of our competitors may have greater resources than we do. Increased competition would make it more difficult for us to purchase or originate investments at attractive prices. As a result of this competition, sometimes we may be precluded from making otherwise attractive investments.

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

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

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 business

development company, 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. See Certain Government Regulations. 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 business development company, 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.

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 price of the common stock may be higher or lower than the price paid by stockholders, depending on many factors, some of which are beyond our control and may not be directly related to our operating performance. These factors include, but are not limited to, the following:

- price and volume fluctuations in the overall stock market from time to time;
- significant volatility in the market price and trading volume of securities of business development companies or other financial services companies;
- volatility resulting from trading in derivative securities related to our common stock including puts, calls, long-term equity anticipation securities, or LEAPs, or short trading positions;
- changes in laws or regulatory policies or tax guidelines with respect to business development companies or regulated investment companies;
- actual or anticipated changes in our earnings or fluctuations in our operating results or changes in the expectations of securities analysts;
- general economic conditions and trends;
- loss of a major funding source; or
- departures of key personnel.

The trading market or market value of our publicly issued debt securities may be volatile. 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 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 credit ratings may not reflect all risks of an investment in the debt securities. Our credit ratings are an assessment of our ability to pay our obligations. Consequently, real or anticipated changes in our credit ratings will generally affect the market value of the publicly issued debt securities. Our credit ratings, however, may not reflect the potential impact of risks related to market conditions generally or other factors discussed above on the market value of, or trading market for, the publicly issued debt securities.

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

Disclosure Regarding Forward-Looking Statements

Information contained or incorporated by reference in this prospectus, and any prospectus supplement accompanying this prospectus contains forward-looking statements. These statements include the plans and objectives of management for future operations and financial objectives and can be identified by the use of forward-looking terminology such as may, will, expect, intend, anticipate, estimate or con the negative thereof or other variations thereon or comparable terminology. These forward-looking statements are subject to the inherent uncertainties in predicting future results and conditions. Certain factors that could cause actual results and conditions to differ materially from those projected in these forward-looking statements are set forth above in the Risk Factors section. Other factors that could cause actual results to differ materially include:

- changes in the economy;
- risks associated with possible disruption in our operations due to terrorism;
- future changes in laws or regulations and conditions in our operating areas; and
- other risks and uncertainties as may be detailed from time to time in our public announcements and SEC filings.

The matters described in Risk Factors and certain other factors noted throughout this prospectus, and any prospectus supplement accompanying this prospectus and in any exhibits to the registration statement of which this prospectus is a part, constitute cautionary statements identifying important factors with respect to any such forward-looking statements, including certain risks and uncertainties, that could cause actual results to differ materially from those in such forward-looking statements.

Although we believe that the assumptions on which these forward-looking statements are based are reasonable, any of those assumptions could prove to be inaccurate, and as a result, the forward-looking statements based on those assumptions also could be incorrect. Important assumptions include our ability to originate new investments, maintain certain margins and levels of profitability, access the capital markets for debt and equity capital, the ability to meet regulatory requirements and the ability to maintain certain debt to asset ratios. In light of these and other uncertainties, the inclusion of a projection or forward-looking statement in this prospectus and any prospectus supplement accompanying this prospectus should not be regarded as a representation by us that our plans and objectives will be achieved. You should not place undue reliance on these forward-looking statements, which apply only as of the date of this prospectus and the date on the cover of any such supplements with respect to such supplements. The forward-looking statements contained in this prospectus and any accompanying prospectus supplement are excluded from the safe harbor protection provided by Section 27A of the Securities Act of 1933.

USE OF PROCEEDS

We intend to use the net proceeds from selling shares of our common stock for general corporate purposes, which may include investing in debt or equity securities in primarily privately negotiated transactions, repayment of indebtedness, acquisitions and other general corporate purposes. Because our primary business is to provide long-term debt and equity capital to primarily middle-market companies, we are continuously identifying, reviewing and, to the extent consistent with our investment objective, funding new investments. As a result, we typically raise capital as we deem appropriate to fund such new investments. Any supplement to this prospectus relating to an offering will more fully identify the use of the proceeds from such offering.

We anticipate that substantially all of the net proceeds of any offering of shares of our common stock will be used, as described above or in any prospectus supplement accompanying this prospectus, within six months, but in no event longer than two years. Pending investment, we intend to invest the net proceeds of any offering of shares of our common stock in time deposits, income-producing securities with maturities of three months or less that are issued or guaranteed by the federal government or an agency of the federal government, high quality debt securities maturing in one year or less from the time of investment or other qualifying investments. Our ability to achieve our investment objective may be limited to the extent that the net proceeds of any offering, pending full investment, are held in lower-yielding time deposits and other short-term instruments.

PRICE RANGE OF COMMON STOCK AND DISTRIBUTIONS

Our common stock is traded on the New York Stock Exchange under the symbol ALD. The following table lists the high and low closing sales prices for our common stock, the closing sales price as a percentage of net asset value (NAV) and quarterly dividends per share. On May 30, 2007, the last reported closing sale price of our common stock was $31.66 per share.

	NAV[1]	Closing Sales Price		Premium of High Sales Price to NAV[2]	Premium of Low Sales Price to NAV[2]	Declared Dividends
		High	Low			
Year ended December 31, 2005						
First Quarter	$15.22	$27.84	$24.89	183%	164%	$0.57
Second Quarter	$17.01	$29.29	$25.83	172%	152%	$0.57
Third Quarter	$17.37	$29.17	$26.92	168%	155%	$0.58
Fourth Quarter	$19.17	$30.80	$26.11	161%	136%	$0.58
Extra Dividend						$0.03
Year ended December 31, 2006						
First Quarter	$19.50	$30.68	$28.51	157%	146%	$0.59
Second Quarter	$19.17	$31.32	$28.77	163%	150%	$0.60
Third Quarter	$19.38	$30.88	$27.30	159%	141%	$0.61
Fourth Quarter	$19.12	$32.70	$29.99	171%	157%	$0.62
Extra Dividend						$0.05
Year ended December 31, 2007						
First Quarter	$19.58	$32.98	$28.05	168%	143%	$0.63
Second Quarter (through May 30, 2007)	*	$31.71	$28.90	*	*	$0.64

(1) Net asset value per share is determined as of the last day in the relevant quarter and therefore may not reflect the net asset value per share on the date of the high and low sales prices. The net asset values shown are based on outstanding shares at the end of each period.

(2) Calculated as the respective high or low closing sales price divided by NAV.

* Not determinable at the time of filing.

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

We intend to pay quarterly dividends to shareholders of our common stock. The amount of our quarterly dividends is determined by our Board of Directors. Our Board of Directors has established a dividend policy to review the dividend rate quarterly, and may adjust the quarterly dividend rate throughout the year. See Management s Discussion and Analysis of Financial Condition and Results of Operations Dividends and Distributions and Tax Status. There can be no assurance that we will achieve investment results or maintain a tax status that will permit any particular level of dividend payment. Certain of our credit facilities limit our ability to declare dividends if we default under certain provisions.

We maintain an opt in dividend reinvestment plan for our common shareholders. As a result, if our Board of Directors declares a dividend, then our shareholders will receive cash dividends, unless they specifically opt in to the dividend reinvestment plan to reinvest their dividends and receive additional shares of common stock. See Dividend Reinvestment Plan.

MANAGEMENT S DISCUSSION AND ANALYSIS

OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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

changes in the economy;

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

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

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

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

OVERVIEW

As a business development company, we are in the private equity business. Specifically, we provide long-term debt and equity investment capital to companies in a variety of industries. Our private finance activity principally involves providing financing to middle market U.S. companies through privately negotiated long-term debt and equity investment capital. Our financing is generally used to fund buyouts, acquisitions, growth, recapitalizations, note purchases, and other types of financings. We generally invest in private companies though, from time to time, we may invest in companies that are public but lack access to additional public capital. Our investment objective is to achieve current income and capital gains.

Our portfolio composition at March 31, 2007 and 2006, and at December 31, 2006, 2005, and 2004, was as follows:

	March 31,		December 31,		
	2007	2006	2006	2005	2004
Private finance	97%	96%	97%	96%	76%
Commercial real estate finance[1]	3%	4%	3%	4%	24%

(1) On May 3, 2005, we completed the sale of our portfolio of non-investment grade commercial mortgage-backed securities and real estate related collateralized debt obligation bonds and preferred shares investments. Upon the completion of this transaction, our lending and investment activity has been focused primarily on private finance investments.

Our earnings depend primarily on the level of interest and dividend income, fee and other income, and net realized and unrealized gains or losses on our investment portfolio after deducting interest expense on borrowed capital, operating expenses and income taxes, including excise tax. Interest income results from the stated interest rate earned on a loan or debt security and the amortization of loan origination fees and discounts. The level of interest income is directly related to the balance of the interest-bearing investment portfolio outstanding during the period 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. The level of investment activity can vary substantially from period to period depending on many factors, including the amount of debt and equity capital available to middle market companies, the level of merger and acquisition activity for such companies, the general economic environment, and the competitive environment for the types of investments we make.

Because we are a regulated investment company for tax purposes, we intend to distribute substantially all of our annual taxable income available for distribution to shareholders as dividends to our shareholders. See Other Matters below.

PORTFOLIO AND INVESTMENT ACTIVITY

The total portfolio at value, investment activity, and the yield on interest-bearing investments at and for the three months ended March 31, 2007 and 2006, and at and for the years ended December 31, 2006, 2005, and 2004, were as follows:

	At and for the Three Months Ended March 31,		At and for the Years Ended December 31,		
($ in millions)	2007	2006	2006	2005	2004
Portfolio at value	$4,498.8	$3,691.0	$4,496.1	$3,606.4	$3,013.4
Investments funded[1]	$ 170.2	$ 797.9	$2,437.8	$1,675.8	$1,524.5
Change in accrued or reinvested interest and dividends[2]	$ 11.3	$ (2.1)	$ 11.3	$ 6.6	$ 52.2
Principal collections related to investment repayments or sales	$ 235.5	$ 340.4	$1,055.3	$1,503.4	$ 909.2
Yield on interest-bearing investments[3]	11.6%	12.3%	11.8%	12.8%	14.0%

(1) Investments funded included investments acquired through the issuance of our common stock as consideration totaling $7.2 million and $3.2 million, respectively, for the years ended December 31, 2005 and 2004. See also Private Finance below.

(2) Includes changes in accrued or reinvested interest related to our investments in money market securities of $2.6 million and $1.1 million, respectively, for the three months ended March 31, 2007 and 2006, and $3.1 million for the year ended December 31, 2006.

(3) 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, divided by (b) total interest-bearing investments at value. The weighted average yield is computed as of the balance sheet date.

Private Finance

The private finance portfolio at value, investment activity, and the yield on loans and debt securities at and for the three months ended March 31, 2007 and 2006, and at and for the years ended December 31, 2006, 2005, and 2004, were as follows:

	At and for the Three Months Ended March 31,				At and for the Years Ended December 31,					
	2007		2006		2006		2005		2004	
($ in millions)	Value	Yield(2)	Value	Yield(2)	Value	Yield(2)	Value	Yield(2)	Value	Yield(2)
Portfolio at value:										
Loans and debt securities:										
Senior loans	$ 365.0	8.4%	$ 420.1	9.3%	$ 405.2	8.4%	$ 239.8	9.5%	$ 234.6	8.5%
Unitranche debt	780.2	11.4%	362.7	11.1%	799.2	11.2%	294.2	11.4%	43.9	14.8%
Subordinated debt	1,946.1	12.5%	1,747.2	13.6%	1,980.8	12.9%	1,560.9	13.8%	1,324.4	14.9%
Total loans and debt securities	3,091.3	11.7%	2,530.0	12.5%	3,185.2	11.9%	2,094.9	13.0%	1,602.9	13.9%
Equity securities	1,285.0		1,031.6		1,192.7		1,384.4		699.2	
Total portfolio	$4,376.3		$3,561.6		$4,377.9		$3,479.3		$2,302.1	
Investments funded(1)	$ 170.2		$ 795.9		$2,423.4		$1,462.3		$1,140.8	
Change in accrued or reinvested interest and dividends	$ 9.1		$ (4.2)		$ 7.2		$ 24.6		$ 45.6	
Principal collections related to investment repayments or sales(3)	$ 235.1		$ 336.6		$1,015.4		$ 703.9		$ 551.9	

(1) Investments funded for the three months ended March 31, 2006, and for the years ended December 31, 2006 and 2004, included debt investments in certain portfolio companies received in conjunction with the sale of such companies. See Private Finance, Investments Funded below.

(2) 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.

(3) Includes collections from the sale or repayment of senior loans totaling $94.7 million and $13.2 million for the three months ended March 31, 2007 and 2006, respectively, and $322.7 million, $301.8 million, and $35.6 million for the years ended December 31, 2006, 2005, and 2004, respectively.

Our investment activity is focused on making long-term investments in the debt and equity of primarily private middle market companies. Debt investments may include senior loans, unitranche debt (a single debt investment that is a blend of senior and subordinated debt terms), or subordinated debt (with or without equity features). The junior debt that we invest in that is lower in repayment priority than senior debt is also known as mezzanine debt. Equity investments may include a minority equity stake in connection with a debt investment or a substantial equity stake in connection with a buyout transaction. In a buyout transaction, we generally invest in senior and/or subordinated debt and equity (preferred and/or voting or non-voting common) where our equity ownership represents a significant portion of the equity, but may or may not represent a controlling interest.

We intend to take a balanced approach to private equity investing that emphasizes a complementary mix of debt investments and buyout investments. The combination of these two types of investments provides current interest and related portfolio income and the potential for future capital gains. The private equity investment marketplace is very active. Purchase price multiples remain high and debt pricing is competitive. In this competitive market, we are focusing on investments that provide the opportunity for attractive total returns such as buyout

investments or debt investments where we can make co-investments

in the portfolio company s equity securities. In many instances we believe that debt-only investments, which provide only interest income with no potential for future capital gain, may be unattractive for our portfolio in today s competitive pricing environment.

In our debt investing we may provide both senior and subordinated debt or unitranche debt, where our combined current yield may be lower than traditional subordinated debt only. We believe that providing both senior and subordinated debt or unitranche debt provides us with greater protection in the capital structures of our portfolio companies.

The level of investment activity for investments funded and principal repayments for private finance investments can vary substantially from period to period depending on the number and size of investments that we make or that we exit and many other factors, including the amount of debt and equity capital available to middle market companies, the level of merger and acquisition activity for such companies, the general economic environment, and the competitive environment for the types of investments we make.

In the current market, we believe that it is important to be disciplined in our investing activities, carefully considering investment risk and return. For the first quarter of 2007, we reviewed over $20 billion in prospective investments and we closed on approximately 1% of the potential new investments we reviewed. For 2006, we reviewed over $65 billion in prospective investments and we closed on approximately 3% of the potential new investments that we reviewed. This compares to over $45 billion reviewed and approximately 3% closed for 2005. We continue to have an active pipeline of new investments under consideration and we believe that merger and acquisition activity for middle market companies will remain strong in 2007.

Investments Funded. Investments funded and the weighted average yield on loans and debt securities funded for the three months ended March 31, 2007, and for the years ended December 31, 2006, 2005, and 2004, consisted of the following:

	For the Three Months Ended March 31, 2007					
	Debt Investments		Buyout Investments		Total	
($ in millions)	Amount	Yield(1)	Amount	Yield(1)	Amount	Yield(1)
Loans and debt securities:						
Senior loans	$41.2	8.8%	$12.7	10.4%	$ 53.9	9.2%
Unitranche debt(2)	5.3	11.0%			5.3	11.0%
Subordinated debt	14.4	9.3%	62.1	10.5%	76.5	10.3%
Total loans and debt securities	60.9	9.1%	74.8	10.5%	135.7	9.9%
Equity	9.7		24.8		34.5	
Total	$70.6		$99.6		170.2	

	2006 Investments Funded					
	Debt Investments		Buyout Investments		Total	
($ in millions)	Amount	Yield(1)	Amount	Yield(1)	Amount	Yield(1)
Loans and debt securities:						
Senior loans	$ 245.4	9.4%	$ 239.8	8.9%	$ 485.2	9.2%
Unitranche debt(2)	471.7	10.7%	146.5	12.9%	618.2	11.3%
Subordinated debt(3)	510.7	13.0%	423.8	14.4%	934.5	13.6%
Total loans and debt securities	1,227.8	11.4%	810.1	12.5%	2,037.9	11.9%
Equity	91.4(5)		294.1		385.5	
Total	$1,319.2		$1,104.2		$2,423.4	

	2005 Investments Funded					
	Debt Investments		Buyout Investments		Total	
($ in millions)	Amount	Yield(1)	Amount	Yield(1)	Amount	Yield(1)
Loans and debt securities:						
Senior loans	$ 76.8	10.0%	$250.2	6.4%	$ 327.0	7.2%
Unitranche debt(2)	259.5	10.5%			259.5	10.5%
Subordinated debt	296.9(4)	12.3%	330.9	12.5%	627.8	12.4%
Total loans and debt securities	633.2	11.3%	581.1	9.9%	1,214.3	10.6%
Equity	82.5(5)		165.5		248.0	

Total	$715.7		$746.6		$1,462.3	

($ in millions)	2004 Investments Funded					
	Debt Investments		Buyout Investments		Total	
	Amount	Yield[1]	Amount	Yield[1]	Amount	Yield[1]
Loans and debt securities:						
Senior loans	$ 25.1	9.1%	$140.8	7.2%	$ 165.9	7.5%
Unitranche debt[2]	18.9	13.0%			18.9	13.0%
Subordinated debt[3]	396.4	13.4%	320.1	15.5%	716.5	14.4%
Total loans and debt securities	440.4	13.2%	460.9	13.0%	901.3	13.1%
Equity	72.3(5)		167.2		239.5	
Total	$512.7		$628.1		$1,140.8	

(1) The weighted average yield on interest-bearing investments is computed as the (a) annual stated interest on accruing interest-bearing investments, divided by (b) total interest-bearing investments funded.

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

(3) Debt investments funded for the year ended December 31, 2006, included a $150 million subordinated debt investment in Advantage Sales & Marketing, Inc. received in conjunction with the sale of Advantage and a $30 million subordinated debt investment in STS Operating, Inc. received in conjunction with the sale of STS. Debt investments funded for the year ended December 31, 2004, included a $47.5 million subordinated debt investment in The Hillman Companies, Inc. received in conjunction with the sale of Hillman.

(4) Subordinated debt investments for the year ended December 31, 2005, included $45.5 million in investments in the bonds of collateralized loan obligations (CLOs) and collateralized debt obligations (CDOs) that are managed by Callidus Capital Corporation (Callidus), a portfolio company controlled by us. These CLOs and CDOs primarily invest in senior debt.

(5) Equity investments for the years ended December 31, 2006, 2005, and 2004, included $26.1 million, $47.9 million, and $23.6 million, respectively, in investments in the preferred shares/income notes of CLOs and CDOs that are managed by Callidus. These CDOs and CLOs primarily invest in senior debt.

Private finance investments funded April 1, 2007, through May 4, 2007, totaled approximately $290 million.

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

We may originate, underwrite and arrange senior loans related to our portfolio investments or for other companies that are not in our portfolio. Senior loans originated by us may or may not be funded by us at closing. When these senior loans are closed, we may fund all or a portion of the underwritten commitment pending sale of the loan to other investors, which may include loan sales to Callidus Capital Corporation (Callidus) or funds managed by Callidus, a portfolio company controlled by us. In addition, we are in the process of developing a fund to invest in senior debt opportunities, which, if closed, we may sell a portion of our senior or unitranche loans to the fund. After completion of loan sales, we may or may not retain a position in these senior loans. We generally earn a fee on the senior loans originated and underwritten 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. Repayments include repayments of senior debt funded by us that was subsequently sold by us or refinanced or repaid by the portfolio companies.

Yield. The weighted average yield on the private finance loans and debt securities was 11.7% at March 31, 2007, as compared to 12.5%, 11.9%, 13.0% and 13.9% at March 31, 2006, and December 31, 2006, 2005, and 2004, respectively. The weighted average yield on the private finance loans and debt securities may fluctuate from period to period depending on the yield on new loans and debt securities funded, the yield on loans and debt securities repaid, the amount of loans and debt securities for which interest is not accruing (see Portfolio Asset Quality Loans and Debt Securities on Non-Accrual Status below) and the amount of lower-yielding senior or unitranche debt in the portfolio at the end of the period. Yields on senior and subordinated debt investments are generally lower in the current market as a result of the supply of capital available to middle market companies. We believe that debt yields will remain on the lower end of a historical range as long as merger and acquisition activity remains robust and the supply of capital remains strong.

The yield on the private finance portfolio has declined partly due to our strategy to pursue investments where our position in the portfolio company capital structure is more senior, such as senior debt and unitranche investments that typically have lower yields than subordinated debt investments. Our weighted average yield at December 31, 2006, was also reduced by 0.5% as a result of the guaranteed dividend yield on our investment in BLX s 25% Class A equity interests being placed on non-accrual status in the fourth quarter of 2006. These Class A equity interests remained on non-accrual status in the first quarter of 2007. The Class A equity interests are included in our loans and debt securities. See Business Loan Express, LLC below.

Outstanding Investment Commitments. At March 31, 2007, 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	$ 18.7	$ 15.7	$ 90.3	$ 124.7(2)
Unitranche debt			60.2	60.2
Subordinated debt	44.2	0.1		44.3
Total loans and debt securities	62.9	15.8	150.5	229.2
Equity securities	83.0	16.0	73.7	172.7(3)
Total	$ 145.9	$ 31.8	$ 224.2	$ 401.9

(1) Includes various commitments to Callidus Capital Corporation (Callidus), a portfolio company controlled by us, which owns 80% (subject to dilution) of Callidus Capital Management, LLC, an asset management company that structures and manages collateralized debt obligations (CDOs), collateralized loan obligations (CLOs), and other related investments, as follows:

($ in millions)	Committed Amount	Amount Drawn	Amount Available to be Drawn
Revolving line of credit for working capital	$ 4.0	$ (1.1)	$ 2.9
Subordinated debt to support warehouse facilities & warehousing activities(*)	44.0		44.0
Purchase of preferred equity in future CLO transactions	73.2		73.2
Total	$ 121.2	$ (1.1)	$ 120.1

(*) Callidus has a secured warehouse credit facility with a third party for up to $360 million. The facility is used primarily to finance the acquisition of loans pending securitization through a CDO or CLO. In addition, Callidus has a synthetic credit facility with a third party for up to $50 million. In conjunction with these facilities, we have agreed to designate our subordinated debt commitment for Callidus to draw upon to provide first loss capital as needed to support the facilities.

(2) Includes $105.6 million in the form of revolving senior debt facilities to 29 companies.

(3) Includes $89.8 million to 19 private equity and venture capital funds, including $4.3 million in co-investment commitments to one private equity fund.

In addition to these outstanding investment commitments at March 31, 2007, we may be required to fund additional amounts under earn-out arrangements primarily related to buyout transactions in the future if those companies meet agreed-upon performance targets. We also had commitments to private finance portfolio companies in the form of standby letters of credit and guarantees totaling $222.1 million. See Financial Condition, Liquidity and Capital Resources.

Mercury Air Centers, Inc. At March 31, 2007, our investment in Mercury Air Centers, Inc. (Mercury) totaled $84.8 million at cost and $301.4 million at value, or 6.0% of our total assets, which included unrealized appreciation of $216.6 million. At December 31, 2006, our investment in Mercury totaled $84.3 million at cost and $244.2 million at value, which included unrealized appreciation of $159.9 million.

Mercury owns and operates fixed base operations generally under long-term leases from local airport authorities, which consist of terminal and hangar complexes that service the needs of the general aviation community. Mercury is headquartered in Richmond Heights, OH. We completed the purchase of a majority ownership in Mercury in April 2004.

Total interest and related portfolio income earned from our investment in Mercury for the three months ended March 31, 2007 and 2006, and for the years ended December 31, 2006, 2005, and 2004, was as follows:

	Three Months Ended March 31,		Year Ended December 31,		
($ in millions)	2007	2006	2006	2005	2004
Interest income	$2.0	$2.9	$9.3	$8.8	$5.5
Fees and other income	0.1	0.2	0.6	0.7	1.9
Total interest and related portfolio income	$2.1	$3.1	$9.9	$9.5	$7.4

Interest income from Mercury for the three months ended March 31, 2007 and 2006, and for the years ended December 31, 2006, 2005, and 2004, included interest income of $0.5 million, $0.5 million, $2.0 million, $1.6 million, and $1.0 million, respectively, which was paid in kind. The interest paid in kind was paid to us through the issuance of additional debt.

Net change in unrealized appreciation or depreciation included a net increase in unrealized appreciation on our investment in Mercury of $56.7 million and $4.7 million for the three months ended March 31, 2007 and 2006, respectively, and $106.1 million, $53.8 million, and zero for the years ended December 31, 2006, 2005, and 2004, respectively.

In April 2007, we signed a definitive agreement to sell our majority equity interest in Mercury. Based on the definitive agreement, Mercury is expected to sell for an enterprise value of approximately $427 million, subject to pre- and post-closing adjustments. In connection with the transaction, we expect to be repaid approximately $50 million of subordinated debt outstanding to Mercury at closing. We also expect to realize a gain on our equity being sold of approximately $240 million, subject to pre- and post-closing adjustments. Approximately $10 million of our proceeds from the sale of our equity will be subject to certain holdback provisions. The transaction is expected to close in the third quarter of 2007 upon satisfying certain closing conditions, including regulatory approvals.

Business Loan Express, LLC. BLX originates, sells, and services primarily real estate secured loans, including real estate secured conventional small business loans, SBA 7(a) loans, and small investment real estate loans. BLX has offices across the United States and is headquartered in New York, NY. We acquired BLX in 2000.

At March 31, 2007, our investment in BLX totaled $314.5 million at cost and $229.9 million at value, or 4.6% of our total assets, which included unrealized depreciation of $84.6 million. At December 31, 2006, our investment in BLX totaled $295.3 million at cost and $210.7 million at value, or 4.3% of our total assets, which included unrealized depreciation of $84.6 million. In the first quarter of 2007, we increased our investment in BLX by $19.2 million by acquiring additional Class A equity interests. In addition, in the first quarter of 2007, the chief executive officer of BLX invested $3.0 million in the form of Class A equity interests in BLX. We agreed to purchase these interests for cash at fair value in the event that BLX amends or otherwise restructures its existing senior credit facility or he is terminated for any reason. The purpose of these additional investments was to fund payments to the SBA discussed below and to provide additional equity to BLX.

Total interest and related portfolio income earned from our investment in BLX for the three months ended March 31, 2007 and 2006, and for the years ended December 31, 2006, 2005, and 2004, was as follows:

($ in millions)	Three Months Ended March 31,		Year Ended December 31,		
	2007	2006	2006	2005	2004
Interest income	$	$3.9	$11.9	$14.3	$23.2
Dividend income				14.0	14.8
Fees and other income	1.4	2.2	7.8	9.2	12.0
Total interest and related portfolio income	$1.4	$6.1	$19.7	$37.5	$50.0

Interest and dividend income from BLX for the three months ended March 31, 2006, and for the years ended December 31, 2006, 2005, and 2004, included interest and dividend income of $1.8 million, $5.7 million, $8.9 million, and $25.4 million, respectively, which was paid in kind. The interest and dividends paid in kind were paid to us through the issuance of additional debt or equity interests. In the fourth quarter of 2006, we placed our investment in BLX s 25% Class A equity interests on non-accrual status. As a result, there was no interest income from our investment in BLX for the three months ended March 31, 2007, and this resulted in lower interest income from our investment in BLX for the first quarter of 2007 as compared to the first quarter of 2006, as well as for 2006 as compared to 2005.

Accrued interest and dividends receivable and other assets included accrued interest and fees due from BLX totaling $1.4 million at March 31, 2007, and $1.7 million at December 31, 2006, which was paid in cash in the first quarter of 2007.

In consideration for providing a guaranty on BLX s revolving credit facility and standby letters of credit (discussed below), we earned fees of $1.4 million and $1.6 million for the three months ended March 31, 2007 and 2006, respectively, and $6.1 million, $6.3 million, and $6.0 million for the years ended December 31, 2006, 2005, and 2004, respectively, which were included in fees and other income above. The remaining fees and other income relate to management fees from BLX. We did not charge a management fee to BLX in the fourth quarter of 2006 or in the first quarter of 2007.

Net change in unrealized appreciation or depreciation included no change in unrealized depreciation on our investment in BLX for the three months ended March 31, 2007, a net decrease in unrealized appreciation of $22.7 million for the three months ended March 31, 2006, a net decrease of $142.3 million and $32.3 million for the years ended December 31, 2006 and 2004, respectively, and a net increase of $2.9 million for the year ended December 31, 2005. See Results of Operations, Valuation of Business Loan Express, LLC below.

BLX is a national, non-bank lender that participates in the SBA s 7(a) Guaranteed Loan Program and is licensed by the SBA as a Small Business Lending Company (SBLC). The Office of the Inspector General of the SBA (OIG) and the United States Secret Service are conducting an ongoing investigation of allegedly fraudulently obtained SBA-guaranteed loans issued by BLX. Specifically, on or about January 9, 2007, BLX became aware of an indictment captioned as the United States v. Harrington, No. 2:06-CR-20662 pending in the United States District Court for the Eastern District of Michigan. The indictment alleges that a former BLX employee in the Detroit office

engaged in the fraudulent origination of loans guaranteed, in substantial part, by the SBA. We understand that BLX is working cooperatively with the U.S. Attorney s Office and the investigating agencies with respect to this matter. The OIG and the U.S. Department of Justice are also conducting a civil investigation of BLX s lending practices in various jurisdictions. These investigations are ongoing. As an SBA lender, BLX is also subject to other SBA and OIG audits, investigations, and reviews. These investigations, audits and reviews, related litigation, changes in the laws or regulations that govern SBLCs or the SBA 7(a) Guaranteed Loan Program, or changes in government funding for this program could have a material adverse impact on BLX and, as a result, could negatively affect our financial results. We have considered these matters in performing the valuation of BLX at March 31, 2007. See Results of Operations, Valuation of Business Loan Express, LLC below. We are monitoring the situation and have retained a third party to work with BLX to conduct a review of BLX s current internal control systems, with a focus on preventing fraud and further strengthening BLX s operations.

On March 6, 2007, BLX entered into an agreement with the SBA. According to the agreement, BLX remains a preferred lender in the SBA 7(a) Guaranteed Loan Program and retains the ability to sell loans into the secondary market. As part of this agreement, BLX agreed to the immediate payment of approximately $10 million to the SBA to cover amounts paid by the SBA with respect to some of the SBA-guaranteed loans that have been the subject of inquiry by the United States Attorney s Office for the Eastern District of Michigan. As part of the SBA s increased oversight, the agreement provides that any loans originated and closed by BLX during the term of the agreement will be reviewed by an independent third party selected by the SBA prior to the sale of such loans into the secondary market. The agreement also requires BLX to repurchase the guaranteed portion of certain loans that default after having been sold into the secondary market, and subjects such loans to a similar third party review prior to any reimbursement of BLX by the SBA. In connection with this agreement, BLX also entered into an escrow agreement with the SBA and an escrow agent in which BLX agreed to deposit $10 million with the escrow agent for any additional payments BLX may be obligated to pay to the SBA in the future. BLX remains subject to SBA rules and regulations and as a result may be required to make additional payments to the SBA in the ordinary course of business. The agreement states that nothing in the agreement shall affect the rights of BLX to securitize or service its loans. Notwithstanding the foregoing, BLX and the SBA are conducting ongoing discussions with respect to BLX s ability to securitize the unguaranteed portions of SBA loans.

On or about January 16, 2007, BLX and Business Loan Center LLC (BLC) became aware of a lawsuit titled, United States, ex rel James R. Brickman and Greenlight Capital, Inc. v. Business Loan Express LLC f/k/a Business Loan Express, Inc.; Business Loan Center LLC f/k/a Business Loan Center, Inc.; Robert Tannenhauser; Matthew McGee; and George Harrigan, 05-CV-3147 (JEC), that is pending in the United States District Court for the Northern District of Georgia. The complaint includes allegations arising under the False Claims Act and relating to alleged fraud in connection with SBA guarantees on shrimp vessel loans made by BLX and BLC. On April 9, 2007, BLX, BLC and the other defendants filed a motion to dismiss the complaint in its entirety. The motions are pending.

At March 31, 2007, BLX had a three-year $500.0 million revolving credit facility provided by third party lenders that matures in March 2009. The revolving credit facility may be expanded through new or additional commitments up to $600.0 million at BLX s option. This facility provides for a sub-facility for the issuance of letters of credit for up to

an amount equal to 25% of the committed facility. We have provided an unconditional guaranty to these revolving credit facility lenders in an amount equal to 50% of the total obligations (consisting of principal, letters of credit issued under the facility, accrued interest, and other fees) of BLX under this facility. At March 31, 2007, the principal amount outstanding on the revolving credit facility was $300.8 million and letters of credit issued under the facility were $55.9 million. The total obligation guaranteed by us at March 31, 2007, was $179.4 million. At March 31, 2007, we had also provided four standby letters of credit totaling $20.0 million in connection with four term securitization transactions completed by BLX.

The guaranty on the BLX revolving line of credit facility can be called by the lenders in the event of a default, which includes certain defaults under our revolving credit facility. Among other requirements, the BLX facility requires that BLX maintain compliance with certain financial covenants such as interest coverage, maximum debt to net worth, asset coverage, and maintenance of certain asset quality metrics. In addition, BLX would have an event of default if BLX failed to maintain its lending status with the SBA and such failure could reasonably be expected to result in a material adverse effect on BLX, or if BLX failed to maintain certain financing programs for the sale or long-term funding of BLX s loans. At March 31, 2007, BLX received waivers from its lenders with respect to non-compliance with certain covenants, including waiver of compliance with the interest coverage ratio and certain other covenants to permit BLX to comply with its obligations under its agreement with the SBA. In addition, BLX and the SBA are conducting ongoing discussions with respect to BLX s ability to securitize the unguaranteed portions of SBA loans. The waiver provides that BLX may retain unguaranteed portions of SBA loans on its balance sheet. Certain of these waivers expire on June 30, 2007.

BLX has a separate non-recourse warehouse facility to enable it to securitize the unguaranteed portion of its SBA loans. BLX has been receiving temporary extensions of the warehouse facility, and the current extension expires on June 1, 2007. BLX is in negotiations with the warehouse facility providers to renew and amend the facility for an additional one year term, subject to satisfactory conclusion of discussions with the SBA with respect to BLX s ability to securitize the unguaranteed portions of SBA loans. If the current facility were to expire without renewal, the outstanding amounts owing to the warehouse providers do not become immediately due and payable. Instead, BLX would be required to apply substantially all collections on the unguaranteed interests that currently are in the warehouse facility to repay the outstanding amounts owing to the warehouse providers until the warehouse providers were paid in full, similar to an amortizing term loan. In such an event, BLX would not have the right to sell additional unguaranteed interests in SBA loans into this facility.

The current market conditions for small business loans remain very competitive, and as a result, BLX continues to experience higher loan prepayments in its securitized loan portfolio. This competitive environment has also had an effect on BLX s ability to grow its SBA loan origination volume. As a result, BLX has introduced non-SBA real estate loan products in order to diversify its lending products and develop new market niches. We are discussing various funding alternatives with BLX to more effectively accommodate their non-SBA real estate lending activities. We believe that the changes in BLX s operations and the effect of BLX s current regulatory issues and ongoing investigations will require a restructure or recapitalization of BLX given the current set of covenants under its revolving credit facility.

We are monitoring BLX s discussions with the SBA, the senior lenders and the warehouse securitization facility providers, and we intend to work with BLX management to implement its business plan, including funding alternatives. The ultimate resolution of these matters could have a material adverse impact on BLX s financial condition, and, as a result, our financial results could be negatively affected.

Advantage Sales & Marketing, Inc. At December 31, 2005, our investment in Advantage totaled $257.7 million at cost and $660.4 million at value, or 16.4% of our total assets, which included unrealized appreciation of $402.7 million. We completed the purchase of a majority ownership in Advantage in June 2004.

On March 29, 2006, we sold our majority equity interest in Advantage. We were repaid our $184 million in subordinated debt outstanding and realized a gain at closing on our equity investment sold of $433.1 million, subject to post-closing adjustments. Subsequent to closing on this sale, we realized additional gains in 2006 resulting from post-closing adjustments totaling $1.3 million. In addition, there is potential for us to receive additional consideration through an earn-out payment that would be based on Advantage s 2006 audited results. Our realized gain of $434.4 million for the year ended December 31, 2006, subject to post-closing adjustments, excludes any earn-out amounts.

As consideration for the common stock sold in the transaction, we received a $150 million subordinated note, with the balance of the consideration paid in cash. In addition, a portion of our cash proceeds from the sale of the common stock were placed in escrow, subject to certain holdback provisions. At March 31, 2007, the amount of the escrow included in other assets on our consolidated balance sheet was approximately $24 million. For tax purposes, the receipt of the $150 million subordinated note as part of our consideration for the common stock sold and the hold back of certain proceeds in escrow has allowed us, through installment treatment, to defer the recognition of taxable income for a portion of our realized gain until the note or other amounts are collected.

In connection with the sale transaction, we retained an equity investment in the business valued at $15 million at closing as a minority shareholder. During the fourth quarter of 2006, Advantage made a distribution on this minority equity investment, which reduced our cost basis to zero and resulted in a realized gain of $4.8 million.

Total interest and related portfolio income earned from our investment in Advantage while we held a majority equity interest was $14.1 million (which included a prepayment premium of $5.0 million) for the three months ended March 31, 2006, and for the year ended December 31, 2006, and $37.4 million and $21.3 million, for the years ended December 31, 2005 and 2004, respectively. In addition, we earned structuring fees of $2.3 million on our new $150 million subordinated debt investment in Advantage upon the closing of the sale transaction in the first quarter of 2006.

Our investment in Advantage at March 31, 2007, which was composed of subordinated debt and a minority equity interest, totaled $152.4 million at cost and $163.4 million at value, which included unrealized appreciation of $11.0 million.

Advantage is a sales and marketing agency providing outsourced sales, merchandising, and marketing services to the consumer packaged goods industry. Advantage has offices across the United States and is headquartered in Irvine, CA.

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 three months ended March 31, 2007 and 2006, and at and for the years ended December 31, 2006, 2005, and 2004, were as follows:

	At and for the Three Months Ended March 31,				At and for the Years Ended December 31,					
	2007		2006		2006		2005		2004	
($ in millions)	Value	Yield[1]	Value	Yield[1]	Value	Yield[1]	Value	Yield[1]	Value	Yield[1]
Portfolio at value:										
CMBS bonds	$		$		$		$		$373.8	14.6%
CDO bonds and preferred shares									212.6	16.8%
Commercial mortgage loans	72.2	7.5%	102.7	7.6%	71.9	7.5%	102.6	7.6%	95.0	6.8%
Real estate owned	21.0		15.0		19.6		13.9		16.9	
Equity interests	29.3		11.7		26.7		10.6		13.0	
Total portfolio	$122.5		$129.4		$118.2		$127.1		$711.3	
Investments funded	$		$ 2.0		$ 14.4		$213.5		$383.7	
Change in accrued or reinvested interest	$ (0.4)		$ 1.0		$ 1.0		$ (18.0)		$ 6.6	
Principal collections related to investment repayments or sales[2]	$ 0.4		$ 3.8		$ 39.9		$799.5		$357.3	

(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.

(2) Principal collections related to investment repayments or sales for the year ended December 31, 2005, included $718.1 million related to the sale of our CMBS and CDO portfolio in May 2005.

Our commercial real estate investments funded for the years ended December 31, 2006, 2005, and 2004, were as follows:

($ in millions)	Face Amount	Discount	Amount Funded
For the Year Ended December 31, 2006			
Commercial mortgage loans	$ 8.0	$	$ 8.0
Equity interests	6.4		6.4
Total	$ 14.4	$	$ 14.4
For the Year Ended December 31, 2005			
CMBS bonds[(1)]	$211.5	$ (90.5)	$121.0
Commercial mortgage loans	88.5	(0.8)	87.7
Equity interests	4.8		4.8
Total	$304.8	$ (91.3)	$213.5
For the Year Ended December 31, 2004			
CMBS bonds	$419.1	$(183.7)	$235.4
CDO bonds and preferred shares	40.5	(0.1)	40.4
Commercial mortgage loans	112.1	(8.2)	103.9
Equity interests	4.0		4.0
Total	$575.7	$(192.0)	$383.7

(1) The CMBS bonds invested in during 2005, were sold on May 3, 2005.

At March 31, 2007, we had outstanding funding commitments related to commercial mortgage loans and equity interests of $8.9 million, and commitments in the form of standby letters of credit and guarantees related to equity interests of $6.9 million.

During the fourth quarter of 2006, we sold commercial mortgage loans with a total outstanding principal balance of $21.1 million and realized a gain of $0.7 million. As these loans were purchased at prices that were based in part on comparable Treasury rates, we had a related hedge in place to protect against movements in Treasury rates. Upon the loan sale, we settled the related hedge, which resulted in a realized gain of $0.5 million, which was included in the realized gain on the sale of $0.7 million. At March 31, 2007, we did not have any similar hedges in place.

Sale of CMBS Bonds and Collateralized Debt Obligation Bonds and Preferred Shares. On May 3, 2005, we completed the sale of our portfolio of commercial mortgage-backed securities (CMBS) and real estate related collateralized debt obligation (CDO) bonds and preferred shares to affiliates of Caisse de dépôt et placement du Québec (the Caisse) for cash proceeds of $976.0 million and a net realized gain of $227.7 million, after transaction and other costs of $7.8 million. Transaction costs included investment banking fees, legal and other professional fees, and other transaction costs. The CMBS and CDO assets sold had a cost basis at closing of $739.8 million, including accrued interest of $21.7 million. Upon the closing of the sale, we settled all the hedge positions relating to these assets, which resulted in a net realized loss of $0.7 million, which was included in the net realized gain on the sale. Under the sale agreement, we agreed not to primarily invest in CMBS and real estate-related CDOs and refrain from certain other real estate-related investing or servicing activities for a period of three years, or through May 2008, subject to certain limitations and excluding our existing portfolio and related activities.

PORTFOLIO ASSET QUALITY

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

At March 31, 2007, and December 31, 2006 and 2005, our portfolio was graded as follows:

	2007		2006		2005	
Grade	Portfolio at Value	Percentage of Total Portfolio	Portfolio at Value	Percentage of Total Portfolio	Portfolio at Value	Percentage of Total Portfolio
($ in millions)						
1	$1,468.8	32.6%	$1,307.3	29.1%	$1,643.0	45.6%
2	2,457.6	54.6	2,672.3	59.4	1,730.8	48.0
3	339.7	7.6	308.1	6.9	149.1	4.1
4	99.3	2.2	84.2	1.9	26.5	0.7
5	133.4	3.0	124.2	2.7	57.0	1.6
	$4,498.8	100.0%	$4,496.1	100.0%	$3,606.4	100.0%

The amount of the portfolio in each grading category may vary substantially from period to period resulting primarily from changes in the composition of the portfolio as a result of new investment, repayment, and exit activity, changes in the grade of investments to reflect our expectation of performance, and changes in investment values.

Total Grade 4 and 5 portfolio assets were $232.7 million, $208.4 million and $83.5 million, respectively, or were 5.2%, 4.6% and 2.3%, respectively, of the total portfolio value at March 31, 2007, and December 31, 2006 and 2005. Grade 4 and 5 assets include loans, debt securities, and equity securities. We expect that a number of investments will be in the Grades 4 or 5 categories from time to time. Part of the private equity business is working with troubled portfolio companies to improve their businesses and protect our investment. The number and amount of investments included in Grade 4 and 5 may fluctuate from period to period. We continue to follow our historical practice of working with portfolio companies in order to recover the maximum amount of our investment.

At March 31, 2007, and December 31, 2006, $155.1 million and $135.9 million, respectively, of our investment in BLX at value was classified as Grade 3, which included our Class A equity interests and certain of our Class B equity interests that were not depreciated. At both March 31, 2007, and December 31, 2006, $74.8 million of our investment in BLX at value was classified as Grade 5, which included certain of our Class B equity interests and our Class C equity interests that were depreciated. At

December 31, 2005, our investment in BLX of $357.1 million at value was classified as Grade 1. See Private Finance, Business Loan Express, LLC above.

Loans and Debt Securities on Non-Accrual Status. At March 31, 2007, and December 31, 2006 and 2005, loans and debt securities at value not accruing interest for the total investment portfolio were as follows:

($ in millions)	2007	2006	2005
Loans and debt securities in workout status (classified as Grade 4 or 5)[1]			
Private finance			
Companies more than 25% owned	$ 45.5	$ 51.1	$ 15.6
Companies 5% to 25% owned	4.9	4.0	
Companies less than 5% owned	61.0	31.6	11.4
Commercial real estate finance	4.9	12.2	12.9
Loans and debt securities not in workout status			
Private finance			
Companies more than 25% owned	121.2	87.1	58.0
Companies 5% to 25% owned	7.2	7.2	0.5
Companies less than 5% owned	26.9	38.9	49.5
Commercial real estate finance	14.3	6.7	7.9
Total	$285.9	$238.8	$155.8
Percentage of total portfolio	6.4%	5.3%	4.3%

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

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 March 31, 2007, and December 31, 2006, our Class A equity interests in BLX of $85.8 million and $66.6 million, which represented 1.9% and 1.5% of the total portfolio at value, respectively, were included in non-accruals. The BLX 25% Class A equity interests were placed on non-accrual status during the fourth quarter of 2006. See Private Finance, Business Loan Express, LLC above.

Loans and Debt Securities Over 90 Days Delinquent. Loans and debt securities greater than 90 days delinquent at value at March 31, 2007, and December 31, 2006 and 2005, were as follows:

($ in millions)	2007	2006	2005
Private finance	$161.4	$46.5	$74.6
Commercial mortgage loans	17.9	1.9	6.1
Total	$179.3	$48.4	$80.7
Percentage of total portfolio	4.0%	1.1%	2.2%

The amount of loans and debt securities over 90 days delinquent increased to $179.3 million at March 31, 2007, from $48.4 million at December 31, 2006. The increase in loans and debt securities over 90 days delinquent primarily relates to not receiving payment

on our Class A equity interests of BLX of $85.8 million, which represented 1.9% of the total portfolio at value. The Class A equity interests were placed on non-accrual during the fourth quarter of 2006. See Private Finance, Business Loan Express, LLC above.

The amount of the portfolio that is on non-accrual status or greater than 90 days delinquent may vary from period to period. Loans and debt securities on non-accrual status and over 90 days delinquent should not be added together as they are two separate measures of portfolio asset quality. Loans and debt securities that are in both categories (i.e., on non-accrual status and over 90 days delinquent) totaled $159.2 million, $44.3 million, and $60.7 million at March 31, 2007, and December 31, 2006 and 2005, respectively.

OTHER ASSETS AND OTHER LIABILITIES

Other assets is composed primarily of fixed assets, assets held in deferred compensation trusts, prepaid expenses, deferred financing and offering costs, and accounts receivable, which includes amounts received in connection with the sale of portfolio companies, including amounts held in escrow, and other receivables from portfolio companies. At March 31, 2007, and December 31, 2006 and 2005, other assets totaled $148.0 million, $123.0 million, and $87.9 million, respectively. The increase since December 31, 2005, was primarily the result of amounts received in connection with the sale of Advantage and certain other portfolio companies that are being held in escrow. See Private Finance above.

Accounts payable and other liabilities is primarily composed of the liabilities related to the deferred compensation trust and accrued interest, bonus and taxes, including excise tax. At March 31, 2007, December 31, 2006 and 2005, accounts payable and other liabilities totaled $116.3 million, $147.1 million, and $102.9 million, respectively. The decrease from December 31, 2006, to March 31, 2007, was primarily the result of the payment of liabilities at December 31, 2006, in the first quarter of 2007 related to accrued 2006 bonuses of $38.0 million, excise tax of $15.4 million and an extra dividend of $7.5 million, offset by an increase in liabilities for the first quarter of 2007 related to accrued 2007 bonuses and excise taxes totaling $13.4 million and an increase in accrued interest payable of $12.5 million. The increase from December 31, 2005 to December 31, 2006, was primarily the result of an increase in the liability related to the deferred compensation trust of $13.6 million, accrued bonus of $11.3 million, accrued interest payable of $10.3 million, and accrued excise tax of $9.2 million. Accrued interest payable fluctuates from period to period depending on the amount of debt outstanding and the contractual payment dates of the interest on such debt.

RESULTS OF OPERATIONS

Comparison of the Three Months Ended March 31, 2007 and 2006

The following table summarizes our operating results for the three months ended March 31, 2007 and 2006.

(in thousands, except per share amounts)	For the Three Months Ended March 31, 2007	2006	Change	Percent Change
	(unaudited)			
Interest and Related Portfolio Income				
Interest and dividends	$101,983	$ 88,881	$ 13,102	15%
Fees and other income	5,969	22,130	(16,161)	(73)%
Total interest and related portfolio income	107,952	111,011	(3,059)	(3)%
Expenses				
Interest	30,288	24,485	5,803	24%
Employee	21,928	21,428	500	2%
Employee stock options	3,661	3,606	55	2%
Administrative	13,224	11,334	1,890	17%
Total operating expenses	69,101	60,853	8,248	14%
Net investment income before income taxes	38,851	50,158	(11,307)	(23)%
Income tax expense (benefit), including excise tax	(649)	8,858	(9,507)	(107)%
Net investment income	39,500	41,300	(1,800)	(4)%
Net Realized and Unrealized Gains (Losses)				
Net realized gains	27,666	432,835	(405,169)	*
Net change in unrealized appreciation or depreciation	65,920	(374,548)	440,468	*
Total net gains (losses)	93,586	58,287	35,299	*
Net income	$133,086	$ 99,587	$ 33,499	34%
Diluted earnings per common share	$ 0.87	$ 0.70	$ 0.17	24%
Weighted average common shares outstanding diluted	152,827	141,738	11,089	8%

* Net change in unrealized appreciation or depreciation and net gains (losses) can fluctuate significantly from period to period. As a result, comparisons may not be 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 three months ended March 31, 2007 and 2006, was composed of the following:

($ in millions)	2007	2006
Interest		
Private finance loans and debt securities	$ 96.6	$82.6
Commercial mortgage loans	1.3	2.8
Cash, U.S. Treasury bills, money market and other securities	2.8	2.9
Total interest	100.7	88.3
Dividends	1.3	0.6
Total interest and dividends	$102.0	$88.9

The level of interest income, which includes interest paid in cash and in kind, is directly related to the balance of the interest-bearing investment portfolio outstanding during the period multiplied by the weighted average yield. The interest-bearing investments in the portfolio at value and the yield on the interest-bearing investments in the portfolio at March 31, 2007 and 2006, were as follows:

	2007		2006	
($ in millions)	Value	Yield(1)	Value	Yield(1)
Private finance loans and debt securities	$3,091.3	11.7%	$2,530.0	12.5%
Commercial mortgage loans	72.2	7.5%	102.7	7.6%
Total	$3,163.5	11.6%	$2,632.7	12.3%

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

Our interest income from our private finance loans and debt securities has increased year over year primarily as a result of the growth in this portfolio, net of the reduction in yield. The private finance portfolio yield at March 31, 2007, of 11.7% as compared to the private finance portfolio yield of 12.5% at March 31, 2006, reflects the mix of debt investments in the private finance portfolio. The weighted average yield varies from period to period based on the current stated interest on loans and debt securities and the amount of loans and debt securities for which interest is not accruing. See the discussion of the private finance portfolio yield above under the caption Portfolio and Investment Activity Private Finance.

Interest income from cash, U.S. Treasury bills, money market and other securities results primarily from interest earned on our liquidity portfolio. See Financial Condition, Liquidity and Capital Resources below. The value and weighted average yield of the liquidity portfolio was $205.0 million and 5.3%, respectively, at March 31, 2007, and $201.8 million and 5.3%, respectively, at December 31, 2006.

Dividend income results from the dividend yield on preferred equity interests, if any, or the declaration of dividends by a portfolio company on preferred or common equity interests. Dividend income will vary from period to period depending upon the timing and amount of dividends that are declared or paid by a portfolio company on preferred or common equity interests.

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 three months ended March 31, 2007 and 2006, included fees relating to the following:

($ in millions)	2007	2006
Structuring and diligence	$1.8	$11.0
Management, consulting and other services provided to portfolio companies[(1)]	1.8	4.1
Commitment, guaranty and other fees from portfolio companies[(2)]	2.0	1.7
Loan prepayment premiums	0.3	5.3
Other income	0.1	
Total fees and other income	$6.0	$22.1

(1) 2006 includes $1.8 million in management fees from Advantage prior to its sale on March 29, 2006. See Portfolio and Investment Activity above for further discussion.

(2) Includes guaranty and other fees from BLX of $1.4 million and $1.6 million for 2007 and 2006, respectively. See Private Finance, Business Loan Express, LLC above.

Fees and other income are generally related to specific transactions or services and therefore may vary substantially from period to period depending on the level of investment activity and types of services provided. Loan origination fees that represent yield enhancement on a loan are capitalized and amortized into interest income over the life of the loan.

Structuring and diligence fees primarily relate to the level of new investment originations. Private finance investments funded were $170.2 million for the three months ended March 31, 2007, as compared to $795.9 million for the three months ended March 31, 2006.

Loan prepayment premiums for the three months ended March 31, 2006, included $5.0 million related to the repayment of our subordinated debt in connection with the sale of our majority equity interest in Advantage on March 29, 2006. See Portfolio and Investment Activity above for further discussion. While the scheduled maturities of private finance and commercial real estate loans generally range from five to ten years, it is not unusual for our borrowers to refinance or pay off their debts to us ahead of schedule. Therefore, we generally structure our loans to require a prepayment premium for the first

three to five years of the loan. Accordingly, the amount of prepayment premiums will vary depending on the level of repayments and the age of the loans at the time of repayment.

Mercury and BLX. Mercury and BLX were our largest investments at value at March 31, 2007 and 2006, and together represented 10.6% and 12.3% of our total assets, respectively.

Total interest and related portfolio income from these investments for the three months ended March 31, 2007 and 2006, was as follows:

($ in millions)	2007	2006
Mercury	$2.1	$3.1
BLX	$1.4	$6.1

See Portfolio and Investment Activity above for further detail on Mercury and BLX.

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

Interest Expense. The fluctuations in interest expense during the three months ended March 31, 2007 and 2006, were primarily attributable to changes in the level of our borrowings under various notes payable and our revolving line of credit. Our borrowing activity and weighted average cost of debt, including fees and debt financing costs, at and for the three months ended March 31, 2007 and 2006, were as follows:

($ in millions)	2007	2006
Total outstanding debt	$1,891.5	$1,274.2
Average outstanding debt	$1,841.2	$1,491.5
Weighted average cost[(1)]	6.5%	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.

In addition, interest expense included interest paid to the Internal Revenue Service related to installment sale gains totaling $0.3 million and $0.2 million for the three months ended March 31, 2007 and 2006, respectively. Installment interest expense for the year ended December 31, 2007, is estimated to be a total of $6.4 million. See Dividends and Distributions below.

Employee Expense. Employee expenses for the three months ended March 31, 2007 and 2006, were as follows:

($ in millions)	2007	2006
Salaries and employee benefits	$21.4	$17.3
Individual performance award (IPA)	2.5	1.7
IPA mark to market expense (benefit)	(4.0)	1.0
Individual performance bonus (IPB)	2.0	1.4
Total employee expense	$21.9	$21.4
Number of employees at end of period	170	155

The change in salaries and employee benefits reflects the effect of an increase in number of employees, compensation increases, and the change in mix of employees given their area of responsibility and relevant experience level. Salaries and employee benefits include an accrual for employee bonuses, which are generally paid annually after the completion of the fiscal year. The quarterly accrual is based upon an estimate of annual bonuses and is subject to change. The amount of the current year bonuses will be finalized by the Compensation Committee and the Board of Directors at the end of the year. Salaries and employee benefits included accrued bonuses of $10.4 million and $7.9 million for the three months ended March 31, 2007 and 2006, respectively.

The IPA is a long-term incentive compensation program for certain officers. The IPA, which is generally determined annually at the beginning of each year, is deposited into a deferred compensation trust generally in four equal installments, on a quarterly basis, in the form of cash. The trustee is required to use the cash to purchase shares of our common stock in the open market. The accounts of the trust are consolidated with our accounts. We are required to mark to market the liability of the trust and this adjustment is recorded to the IPA compensation expense. Because the IPA is deferred compensation, the cost of this award is not a current expense for purposes of computing our taxable income. The expense is deferred for tax purposes until distributions are made from the trust.

We also have an IPB, which is distributed in cash to award recipients equally throughout the year (beginning in February of each year) as long as the recipient remains employed by us.

The Compensation Committee and the Board of Directors have determined the IPA and the IPB for 2007 and they are currently estimated to be approximately $10 million each; however, the Compensation Committee may adjust the IPA or IPB as needed, or make new awards as new officers are hired. If a recipient terminates employment during the year, any further cash contribution for the IPA or remaining cash payments under the IPB would be forfeited.

In connection with our 2006 Annual Meeting of Stockholders, the stockholders approved the issuance of up to 2.5 million shares of our common stock in exchange for the cancellation of vested in-the-money stock options granted to certain officers and directors under our Amended Stock Option Plan. Under the initiative, which has been reviewed and approved by our Board of Directors, all optionees who hold vested stock options with exercise prices below the market value of the stock (or in-the-money options), would be offered the opportunity to receive an Option Cancellation Payment (OCP) equal to the in-the-money value of the stock options cancelled, which would be paid one-half in cash and one-half in shares of our common stock, in exchange for their voluntary cancellation of their vested stock options. As part of this initiative, the Board of Directors has adopted a target ownership program that establishes minimum ownership levels for our senior officers and continues to further align the interests of our officers with those of our stockholders. We have not yet implemented the OCP as of May 8, 2007, but intend to do so in the future.

Based on the 13 million vested options outstanding and the market price of $30.50 of our stock on March 10, 2006, the date used for disclosure in our 2006 proxy, the OCP would be approximately $106 million if all option holders choose to cancel all vested in-the-money options in exchange for the OCP. As of March 31, 2007, there were 17 million vested options outstanding, of which 13 million were in-the-money. Using the market price

of $28.81 of our stock on March 31, 2007, the OCP would be approximately $86 million if all option holders choose to cancel all vested in-the-money options in exchange for the OCP. As the consideration paid by us for the OCP will not exceed the fair value of the options to be canceled, no expense will be recorded for the transaction in accordance with the guidance in FASB Statement No. 123 (Revised 2004). However, the cash portion of the OCP, or approximately one-half of the payment, will reduce our paid in capital and will therefore reduce our net asset value. For income tax purposes, our tax expense resulting from the OCP would be similar to the tax expense that would result from an exercise of stock options in the market. Any tax deduction for us resulting from the OCP or an exercise of stock options in the market would be limited by Section 162(m) of the Code for persons subject to Section 162(m).

Stock Options Expense. In December 2004, the FASB issued Statement No. 123 (Revised 2004), Share-Based Payment (the Statement), which requires companies to recognize the grant-date fair value of stock options and other equity-based compensation issued to employees in the income statement. The Statement was effective January 1, 2006, and it applies to our stock option plan. Our employee stock options are typically granted with ratable vesting provisions, and we amortize the compensation cost over the related service period. The Statement was adopted using the modified prospective method of application, which required us to recognize compensation costs on a prospective basis beginning January 1, 2006. Under this method, the unamortized cost of previously awarded options that were unvested as of January 1, 2006, is recognized over the remaining service period in the statement of operations beginning in 2006, using the fair value amounts determined for proforma disclosure under Statement No. 123. With respect to options granted on or after January 1, 2006, compensation cost based on estimated grant date fair value is recognized in the statement of operations over the service period. The stock option expense for the three months ended March 31, 2007 and 2006, was as follows:

($ in millions)	**2007**	**2006**
Employee Stock Option Expense:		
Previously awarded, unvested options as of January 1, 2006	$3.2	$3.4
Options granted on or after January 1, 2006	0.5	0.2
Total employee stock option expense	$3.7	$3.6

We estimate that the employee-related stock option expense under the Statement that will be recorded in our statement of operations will be approximately $11.8 million, $4.0 million, and $0.1 million for the years ended December 31, 2007, 2008, and 2009, respectively, which includes approximately $1.9 million, $1.0 million, and $0.1 million, respectively, related to options granted since adoption of the Statement (January 1, 2006). This estimate may change if our assumptions related to future option forfeitures change. This estimate does not include any expense related to future stock option grants as the fair value of those stock options will be determined at the time of grant.

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 stock option expense, and various

other expenses. Administrative expenses for the three months ended March 31, 2007 and 2006, were as follows:

($ in millions)	2007	2006
Administrative expenses	$ 9.9	$ 8.4
Investigation related costs	3.3	2.9
Total administrative expenses	$13.2	$11.3

Administrative expenses for the three months ended March 31, 2007, included costs of $1.4 million incurred to engage a third party to work with BLX, a portfolio company controlled by us, to conduct a review of BLX s current internal control systems, with a focus on preventing fraud and further strengthening BLX s operations. See Private Finance, Business Loan Express, LLC above. Excluding these costs, administrative expenses for the three months ended March 31, 2007, were $8.5 million as compared to $8.4 million for the three months ended March 31, 2006.

Investigation related costs include costs associated with requests for information in connection with government investigations and other legal matters. We expect that we will continue to incur legal and other costs associated with these matters. These expenses remain difficult to predict. See Business Legal Proceedings below.

Income Tax Expense (Benefit), Including Excise Tax. Income tax expense (benefit) for the three months ended March 31, 2007 and 2006, was as follows:

($ in millions)	2007	2006
Income tax expense (benefit)	$(4.2)	$0.5
Excise tax expense	3.6	8.4
Income tax expense (benefit), including excise tax	$(0.6)	$8.9

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.

Our estimated annual taxable income for 2007 currently exceeds our estimated dividend distributions to shareholders from such taxable income in 2007, and such estimated excess taxable income will be distributed in 2008. Therefore, we will generally be required to pay a 4% excise tax on the excess of 98% of our taxable income over the amount of actual distributions from such taxable income. We have recorded an estimated excise tax of $3.6 million for the three months ended March 31, 2007. See Dividends and Distributions. 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.

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, which clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes.* This interpretation is effective for fiscal years beginning after December 15, 2006. The adoption of this interpretation did not have a significant effect on our consolidated financial position or our results of operations.

Realized Gains and Losses. Net realized gains 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 for the three months ended March 31, 2007 and 2006, were as follows:

($ in millions)	2007	2006
Realized gains	$33.2	$436.5
Realized losses	(5.5)	(3.7)
Net realized gains	$27.7	$432.8

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 three months ended March 31, 2007 and 2006, we reversed previously recorded unrealized appreciation or depreciation when gains or losses were realized as follows:

($ in millions)	2007	2006
Reversal of previously recorded net unrealized appreciation associated with realized gains	$(32.1)	$(393.6)
Reversal of previously recorded net unrealized depreciation associated with realized losses	5.8	2.7
Total reversal	$(26.3)	$(390.9)

Realized gains for the three months ended March 31, 2007 and 2006, were as follows:

($ in millions)

2007

Portfolio Company	Amount
Private Finance:	
Palm Coast Data, LLC	$20.0
Mogas Energy, LLC	4.5
Tradesmen International, Inc.	3.8
ForeSite Towers, LLC	3.8
Other	1.1
Total realized gains	$33.2

2006

Portfolio Company	Amount
Private Finance:	
Advantage Sales & Marketing, Inc.	$433.1
Nobel Learning Communications, Inc.	1.5
The Debt Exchange, Inc.	1.1

Other	0.2
Total private finance	435.9
Commercial Real Estate:	
Other	0.6
Total commercial real estate	0.6
Total realized gains	$436.5

Realized losses for the three months ended March 31, 2007 and 2006, were as follows:

($ in millions)

2007

Portfolio Company	Amount
Private Finance:	
Legacy Partners Group, LLC	$ 5.8
Other	(0.3)
Total realized losses	$ 5.5

2006

Portfolio Company	Amount
Private Finance:	
Aspen Pet Products, Inc.	$ 1.5
Nobel Learning Communities, Inc.	1.4
Other	0.5
Total private finance	3.4
Commercial Real Estate:	
Other	0.3
Total commercial real estate	0.3
Total realized losses	$ 3.7

Change in Unrealized Appreciation or Depreciation. We determine the value of each investment in our portfolio on a quarterly basis, and changes in value result in unrealized appreciation or depreciation being recognized in our statement of operations. Value, as defined in Section 2(a)(41) of the Investment Company Act of 1940, is (i) the market price for those securities for which a market quotation is readily available and (ii) for all other securities and assets, fair value is as determined in good faith by the Board of Directors. Since there is typically no readily available market value for the investments in our portfolio, we value substantially all of our portfolio investments at fair value as determined in good faith by the Board of Directors pursuant to our valuation policy and a consistently applied valuation process. At March 31, 2007, portfolio investments recorded at fair value were approximately 90% of our total assets. Because of the inherent uncertainty of determining the fair value of investments that do not have a readily available market value, the fair value of our investments determined in good faith by the Board of Directors may differ significantly from the values that would have been used had a ready market existed for the investments, and the differences could be material.

There is no single standard for determining fair value in good faith. As a result, determining fair value requires that judgment be applied to the specific facts and circumstances of each portfolio investment while employing a consistently applied valuation process for the types of investments we make. Unlike banks, we are not permitted to provide a general reserve for anticipated loan losses. Instead, we are required to specifically value each individual investment on a quarterly basis. We will record unrealized depreciation on investments when we believe that an investment has become impaired, including where collection of a loan or realization of an equity security is doubtful, or when the enterprise value of the portfolio company does not currently support the cost of our debt or equity investment. Enterprise value means the entire value of the company to a potential buyer, including the sum of the values of debt and equity securities used to capitalize the enterprise at a point in time. We will record unrealized appreciation if we believe that the underlying portfolio company has appreciated in value and/or our equity security

has appreciated in value. Changes in fair value are recorded in the statement of operations as net change in unrealized appreciation or depreciation.

As a business development company, we have invested in illiquid securities including debt and equity securities of companies and CDO and CLO bonds and preferred shares/income notes. The structure of each debt and equity security is specifically

negotiated to enable us to protect our investment and maximize our returns. We include many terms governing interest rate, repayment terms, prepayment penalties, financial covenants, operating covenants, ownership parameters, dilution parameters, liquidation preferences, voting rights, and put or call rights. Our investments may be subject to certain restrictions on resale and generally have no established trading market. Because of the type of investments that we make and the nature of our business, our valuation process requires an analysis of various factors. Our fair value methodology includes the examination of, among other things, the underlying investment performance, financial condition, and market changing events that impact valuation.

*Valuation Methodology Private Finance*Our process for determining the fair value of a private finance investment begins with determining the enterprise value of the portfolio company. The fair value of our investment is based on the enterprise value at which the portfolio company could be sold in an orderly disposition over a reasonable period of time between willing parties other than in a forced or liquidation sale. The liquidity event whereby we exit a private finance investment is generally the sale, the recapitalization or, in some cases, the initial public offering of the portfolio company.

There is no one methodology to determine enterprise value and, in fact, for any one portfolio company, enterprise value is best expressed as a range of fair values. 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.

If there is adequate enterprise value to support the repayment of our debt, the fair value of our loan or debt security normally corresponds to cost unless the borrower s condition or other factors lead to a determination of fair value at a different amount. The fair value of equity interests in portfolio companies is determined based on various factors, including the enterprise value remaining for equity holders after the repayment of the portfolio company s debt and other preference capital, and other pertinent factors such as recent offers to purchase a portfolio company, recent transactions involving the purchase or sale of the portfolio company s equity securities, liquidation events, or other events. The determined equity values are generally discounted when we have a minority position, restrictions on resale, specific concerns about the receptivity of the capital markets to a specific company at a certain time, or other factors.

CDO/CLO Assets are carried at fair value, which is based on a discounted cash flow model that utilizes prepayment, re-investment and loss assumptions based on historical experience and projected performance, economic factors, the characteristics of the underlying cash flow and comparable yields for similar bonds and preferred shares/income notes, when available. We recognize unrealized appreciation or depreciation on our CDO/CLO Assets as comparable yields in the market change and/ or based on changes in estimated cash flows resulting from changes in prepayment, re-investment or loss assumptions in the underlying collateral pool. We determine the fair value of our CDO/CLO Assets on an individual security-by-security basis. If we were to sell a group of these CDO/CLO 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.

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

We currently intend to continue to work with third-party consultants to obtain assistance in determining fair value for a portion of the private finance portfolio each quarter. We work with these consultants to obtain assistance as additional support in the preparation of our internal valuation analysis. In addition, we may receive third-party assessments of a particular private finance portfolio company s value in the ordinary course of business, most often in the context of a prospective sale transaction or in the context of a bankruptcy process. The valuation analysis prepared by management using these third-party valuation resources, when applicable, is submitted to our Board of Directors for its determination of fair value of the portfolio in good faith.

We receive third-party valuation assistance from Duff & Phelps, LLC (Duff & Phelps) and Houlihan Lokey Howard and Zukin for our private finance portfolio. For the

three months ended March 31, 2007 and 2006, we received third-party valuation assistance as follows:

	2007	2006
	Q1	Q1
Number of private finance portfolio companies reviewed	88	78
Percentage of private finance portfolio reviewed at value	91.8%	87.0%

Professional fees for third-party valuation assistance were $1.5 million for the year ended December 31, 2006, and are estimated to be approximately $1.6 million for 2007.

Net Change in Unrealized Appreciation or Depreciation. Net change in unrealized appreciation or depreciation for the three months ended March 31, 2007 and 2006, consisted of the following:

($ in millions)	2007[1]	2006[1]
Net unrealized appreciation (depreciation)	$ 92.2	$ 16.4
Reversal of previously recorded unrealized appreciation associated with realized gains	(32.1)	(393.6)
Reversal of previously recorded unrealized depreciation associated with realized losses	5.8	2.7
Net change in unrealized appreciation or depreciation	$ 65.9	$ (374.5)

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

Valuation of Mercury Air Centers, Inc. In April 2007, we signed a definitive agreement to sell our majority equity interest in Mercury for an enterprise value of approximately $427 million, subject to pre-and post-closing adjustments. See Portfolio and Investment Activity above. At March 31, 2007, we estimated the enterprise value of Mercury to be $384 million given that the closing of the transaction is subject to certain closing conditions, including regulatory approvals, and the sales price is subject to pre-and post-closing adjustments and certain holdback provisions. Using the enterprise value at March 31, 2007, of $384 million we determined the value of our investments in Mercury to be $301.4 million, which resulted in unrealized appreciation of $216.6 million at March 31, 2007. This is an increase in unrealized appreciation in the first quarter of 2007 of $56.7 million. We received valuation assistance from Duff & Phelps for our investment in Mercury at March 31, 2007, and December 31, 2006. The transaction is expected to close in the third quarter of 2007, upon satisfying certain closing conditions, including regulatory approvals.

Valuation of Business Loan Express, LLC. Our investment in BLX totaled $314.5 million at cost and $229.9 million at value at March 31, 2007, and $295.3 million at cost and $210.7 million at value at December 31, 2006. To determine the value of our investment in BLX at March 31, 2007, we performed numerous valuation analyses to determine a range of values including: (1) analysis of comparable public company trading multiples; (2) analysis of BLX s value assuming an initial public offering; (3) analysis of merger and acquisition transactions for financial services companies; (4) a discounted dividend analysis; and (5) adding BLX s net asset value (adjusted for certain discounts) to the estimated value of BLX s business operations, which was determined by using a discounted cash flow model. In performing the valuation analyses at March 31, 2007, we continued to consider the impact of various changes in BLX s business model due to the competitive environment for small business loans and BLX s newer non-SBA real estate lending products. We also continued to consider BLX s current regulatory issues and ongoing investigations. (See Private Finance, Business Loan Express, LLC above.) We received valuation assistance from Duff & Phelps for our investment in BLX at March 31, 2007, and December 31, 2006.

With respect to the analysis of comparable public company trading multiples and the analysis of BLX s value assuming an initial public offering, we compute a median trailing and forward price earnings multiple to apply to BLX s pro-forma net income adjusted for certain capital structure changes that we believe would likely occur should the company be sold. Each quarter we evaluate which public commercial finance companies should be included in the comparable group. The comparable group at March 31, 2007, was made up of CIT Group, Inc., Financial Federal Corporation, GATX Corporation, and Marlin Business Services Corporation, which is consistent with the comparable group at December 31, 2006.

Our investment in BLX at March 31, 2007, was valued at $229.9 million. This fair value was within the range of values determined by our valuation analyses discussed above. Unrealized depreciation on our investment was $84.6 million at March 31, 2007. Net change in unrealized appreciation or depreciation included no change for the three months ended March 31, 2007, and a net decrease of $22.7 million for the three months ended March 31, 2006.

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 152.8 million and 141.7 million for the three months ended March 31, 2007 and 2006, respectively.

Comparison of the Years Ended December 31, 2006, 2005, and 2004

The following table summarizes our operating results for the years ended December 31, 2006, 2005, and 2004.

(in thousands, except per share amounts)	2006	2005	Change	Percent Change	2005	2004	Change	Percent Change
Interest and Related Portfolio Income								
Interest and dividends	$ 386,427	$317,153	$ 69,274	22%	$317,153	$319,642	$ (2,489)	(1)%
Fees and other income	66,131	56,999	9,132	16%	56,999	47,448	9,551	20%
Total interest and related portfolio income	452,558	374,152	78,406	21%	374,152	367,090	7,062	2%
Expenses								
Interest	100,600	77,352	23,248	30%	77,352	75,650	1,702	2%
Employee	92,902	78,300	14,602	19%	78,300	53,739	24,561	46%
Employee stock options	15,599		15,599					
Administrative	39,005	69,713	(30,708)	(44)%	69,713	34,686	35,027	101%
Total operating expenses	248,106	225,365	22,741	10%	225,365	164,075	61,290	37%
Net investment income before income taxes	204,452	148,787	55,665	37%	148,787	203,015	(54,228)	(27)%
Income tax expense (benefit), including excise tax	15,221	11,561	3,660	32%	11,561	2,057	9,504	462%
Net investment income	189,231	137,226	52,005	38%	137,226	200,958	(63,732)	(32)%
Net Realized and Unrealized Gains (Losses)								
Net realized gains	533,301	273,496	259,805	95%	273,496	117,240	156,256	133%
Net change in unrealized appreciation or depreciation	(477,409)	462,092	(939,501)	*	462,092	(68,712)	530,804	*
Total net gains (losses)	55,892	735,588	(679,696)	*	735,588	48,528	687,060	*
Net income	$ 245,123	$872,814	$(627,691)	(72)%	$872,814	$249,486	$623,328	250%
Diluted earnings per common share	$ 1.68	$ 6.36	$ (4.68)	(74)%	$ 6.36	$ 1.88	$ 4.48	238%
Weighted average common shares outstanding diluted	145,599	137,274	8,325	6%	137,274	132,458	4,816	4%

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

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, 2006, 2005, and 2004, was composed of the following:

($ in millions)	2006	2005	2004
Interest			
Private finance loans and debt securities	$359.9	$251.0	$195.2
CMBS and CDO portfolio		29.4	93.3
Commercial mortgage loans	8.3	7.6	9.4
Cash, U.S. Treasury bills, money market and other securities	14.0	9.4	3.1
Total interest	382.2	297.4	301.0
Dividends	4.2	19.8	18.6
Total interest and dividends	$386.4	$317.2	$319.6

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 period 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, 2006, 2005, and 2004, were as follows:

	2006		2005		2004	
($ in millions)	Value	Yield(1)	Value	Yield(1)	Value	Yield(1)
Private finance loans and debt securities	$3,185.2	11.9%	$2,094.9	13.0%	$1,602.9	13.9%
CMBS and CDO					586.4	15.4%
Commercial mortgage loans	71.9	7.5%	102.6	7.6%	95.0	6.8%
Total	$3,257.1	11.8%	$2,197.5	12.8%	$2,284.3	14.0%

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

Our interest income from our private finance loans and debt securities has increased year over year primarily as a result of the growth in this portfolio, net of the reduction in yield. The private finance portfolio yield at December 31, 2006, of 11.9% as compared to the private finance portfolio yield of 13.0% and 13.9% at December 31, 2005 and 2004, respectively, reflects the mix of debt investments in the private finance portfolio. The weighted average yield varies from year to year based on the current stated interest on loans and debt securities and the amount of loans and debt securities for which interest is not accruing. See the discussion of the private finance portfolio yield above under the caption Portfolio and Investment Activity Private Finance.

There was no interest income from the CMBS and real estate-related CDO portfolio in 2006 as we sold this portfolio on May 3, 2005. The CMBS and CDO portfolio sold had a cost basis of $718.1 million and a weighted average yield on the cost basis of the portfolio of approximately 13.8%. We generally reinvested the principal proceeds from the CMBS and CDO portfolio into our private finance portfolio.

Our interest income from cash, U.S. Treasury bills, money market and other securities has increased primarily as a result of the fluctuations in our level of investments in U.S. Treasury bills, money market and other securities and the weighted average yield on these securities. During the fourth quarter of 2005, we established a liquidity portfolio that is composed primarily of money market and other securities and U.S. Treasury bills. See Financial Condition, Liquidity and Capital Resources below. The value and weighted average yield of the liquidity portfolio was $201.8 million and 5.3%, respectively, at December 31, 2006, and $200.3 million and 4.2%, respectively, at December 31, 2005.

Dividend income results from the dividend yield on preferred equity interests, if any, or the declaration of dividends by a portfolio company on preferred or common equity interests. Dividend income will vary from 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. Dividend income for the year ended December 31, 2006, did not include any dividends from BLX. See Private Finance, Business Loan Express, LLC above. Dividend income for the years ended December 31, 2005 and 2004, included dividends from BLX on the Class B equity interests held by us of $14.0 million and $14.8 million, respectively. For the year ended December 31, 2005, $12.0 million of these dividends were paid in cash and $2.0 million of these dividends were paid through the issuance of additional Class B equity interests. For the year ended December 31, 2004, the dividends were paid through the issuance of additional Class B 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, 2006, 2005, and 2004, included fees relating to the following:

($ in millions)	**2006**	**2005**	**2004**
Structuring and diligence	$37.3	$24.6	$18.4
Management, consulting and other services provided to portfolio companies[1]	11.1	14.4	11.4
Commitment, guaranty and other fees from portfolio companies[2]	8.8	9.3	9.4
Loan prepayment premiums	8.8	6.3	5.5
Other income	0.1	2.4	2.7
Total fees and other income[3]	$66.1	$57.0	$47.4

(1) 2006 includes $1.8 million in management fees from Advantage prior to its sale on March 29, 2006. See Portfolio and Investment Activity above for further discussion. 2005 and 2004 include $6.5 million and $3.1 million, respectively, in management fees from Advantage.

(2) Includes guaranty and other fees from BLX of $6.1 million, $6.3 million, and $6.0 million for 2006, 2005, and 2004, respectively. See Private Finance, Business Loan Express, LLC above.

(3) Fees and other income related to the CMBS and CDO portfolio were $4.1 million and $6.2 million for 2005 and 2004, respectively. As noted above, we sold our CMBS and CDO portfolio on May 3, 2005.

Fees and other income are generally related to specific transactions or services and therefore may vary substantially from year to year depending on the level of investment activity and types of services provided. Loan origination fees that represent yield enhancement on a loan are capitalized and amortized into interest income over the life of the loan.

Structuring and diligence fees primarily relate to the level of new investment originations. Private finance investments funded were $2.4 billion for the year ended December 31, 2006, as compared to $1.5 billion and $1.1 billion for the years ended December 31, 2005 and 2004, respectively. Structuring and diligence fees for the years ended December 31, 2006, 2005, and 2004, included structuring fees from companies more than 25% owned totaling $8.3 million, $9.1 million, and $11.4 million, respectively.

Loan prepayment premiums for the year ended December 31, 2006, included $5.0 million related to the repayment of our subordinated debt in connection with the sale of our majority equity interest in Advantage on March 29, 2006. See Portfolio and Investment Activity above for further discussion. While the scheduled maturities of private finance and commercial real estate loans generally range from five to ten years, it is not unusual for our borrowers to refinance or pay off their debts to us ahead of schedule. Therefore, we generally structure our loans to require a prepayment premium for the first three to five years of the loan. Accordingly, the amount of prepayment premiums will vary depending on the level of repayments and the age of the loans at the time of repayment.

Mercury, BLX and Advantage. Mercury and BLX were our largest investments at value at December 31, 2006, and together represented 9.3% of our total assets. Advantage and BLX were our largest investments at value at December 31, 2005 and 2004, and together represented 25.3% and 19.0% of our total assets, respectively.

Total interest and related portfolio income from these investments for the years ended December 31, 2006, 2005, and 2004, was as follows:

($ in millions)	2006	2005	2004
Mercury	$ 9.9	$ 9.5	$ 7.4
BLX	$19.7	$37.5	$50.0
Advantage[(1)]	$14.1	$37.4	$21.3

(1) Includes income from the period we had a majority interest only. See Portfolio and Investment Activity above for further discussion.

See Portfolio and Investment Activity above for further detail on Mercury, BLX and Advantage.

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, 2006, 2005, and 2004, were primarily attributable to changes in the level of our borrowings under various notes payable and our revolving line of credit. Our borrowing

activity and weighted average cost of debt, including fees and debt financing costs, at and for the years ended December 31, 2006, 2005, and 2004, were as follows:

($ in millions)	2006	2005	2004
Total outstanding debt	$1,899.1	$1,284.8	$1,176.6
Average outstanding debt	$1,491.0	$1,087.1	$ 985.6
Weighted average cost[(1)]	6.5%	6.5%	6.6%

(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.

In addition, interest expense included interest paid to the Internal Revenue Service related to installment sale gains totaling $0.9 million and $0.6 million for the years ended December 31, 2006 and 2005, respectively. See Dividends and Distributions below.

Interest expense also included interest on our obligations to replenish borrowed Treasury securities related to our hedging activities of $0.7 million, $1.4 million, and $5.2 million for the years ended December 31, 2006, 2005, and 2004, respectively.

Employee Expense. Employee expenses for the years ended December 31, 2006, 2005, and 2004, were as follows:

($ in millions)	2006	2005	2004
Salaries and employee benefits	$73.8	$57.3	$40.7
Individual performance award (IPA)	8.1	7.0	13.4
IPA mark to market expense (benefit)	2.9	2.0	(0.4)
Individual performance bonus (IPB)	8.1	6.9	
Transition compensation, net[(1)]		5.1	
Total employee expense	$92.9	$78.3	$53.7
Number of employees at end of period	170	131	162

(1) Transition compensation for the year ended December 31, 2005, included $3.1 million of costs under retention agreements and $3.1 million of transition services bonuses awarded to certain employees in the commercial real estate group as a result of the sale of the CMBS and CDO portfolio. Transition compensation costs were reduced by $1.1 million for salary reimbursements from CWCapital under a transition services agreement.

The change in salaries and employee benefits reflects the effect of an increase in number of employees, compensation increases, and the change in mix of employees given their area of responsibility and relevant experience level. The overall increase in employee expense during 2006 also reflects the competitive environment for attracting and retaining talent in the private equity industry. Salaries and employee benefits include an accrual for employee bonuses, which are generally paid annually after the completion of the fiscal year. Salaries and employee benefits included bonus expense of $38.2 million, $26.9 million, and $12.4 million for the years ended December 31, 2006, 2005, and 2004, respectively.

At December 31, 2006 and 2005, the total accrued bonus was $38.2 million and $26.9 million, respectively, and was included in Accounts Payable and Other Liabilities on the accompanying Balance Sheet.

See Employee Expense included in the Comparison of the Three Months Ended March 31, 2007 and 2006 above for a discussion of the IPA and the IPB.

Stock Options Expense. In December 2004, the FASB issued Statement No. 123 (Revised 2004), Share-Based Payment (the Statement). We adopted the Statement in the first quarter of 2006 as discussed above under Stock Options Expense included in the Comparison of the Three Months Ended March 31, 2007 and 2006. The stock option expense for the year ended December 31, 2006, was as follows:

($ in millions)	2006
Employee Stock Option Expense:	
Previously awarded, unvested options as of January 1, 2006	$13.2
Options granted on or after January 1, 2006	2.4
Total employee stock option expense	$15.6

In addition to the employee stock option expense, for the year ended December 31, 2006, administrative expense included $0.2 million of expense related to options granted to directors during the year. Options granted to non-officer directors vest on the grant date and therefore, the full expense is recorded on the grant date.

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 stock option expense, and various other expenses. Administrative expenses for the years ended December 31, 2006, 2005, and 2004, were as follows:

($ in millions)	2006	2005	2004
Administrative expenses	$34.0	$33.3	$30.1
Investigation related costs	5.0	36.4	4.6
Total administrative expenses	$39.0	$69.7	$34.7

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

Investigation related costs include costs associated with requests for information in connection with government investigations and other legal matters. We expect that we will continue to incur legal and other costs associated with these matters. These expenses remain difficult to predict. See Business Legal Proceedings below.

Income Tax Expense (Benefit), Including Excise Tax. Income tax expense (benefit) for the years ended December 31, 2006, 2005, and 2004, was as follows:

($ in millions)	2006	2005	2004
Income tax expense (benefit)	$ 0.1	$ 5.4	$1.1
Excise tax expense[(1)]	15.1	6.2	1.0
Income tax expense (benefit), including excise tax	$15.2	$11.6	$2.1

(1) 2006 includes an accrual for estimated excise tax of $15.4 million for the year ended December 31, 2006, net of the reversal of over accrued estimated excise taxes related to 2005 of $0.3 million.

Our wholly owned subsidiary, A.C. Corporation, is a corporation subject to federal and state income taxes and records a benefit or expense for income taxes as appropriate based on its operating results in a given period. In addition, our estimated annual taxable income for 2006 exceeded our dividend distributions to shareholders for 2006 from such taxable income, and such estimated excess taxable income will be distributed in 2007. Therefore, we will be required to pay a 4% excise tax on the excess of 98% of our taxable income for 2006 over the amount of actual distributions for 2006. Accordingly, we accrued an estimated excise tax of $15.4 million for the year ended December 31, 2006, based upon our current estimate of annual taxable income for 2006. See Dividends and Distributions.

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. At December 31, 2006 and 2005, excise tax payable was $15.4 million and $6.2 million, respectively, which was included in Accounts Payable and Other Liabilities on the accompanying Balance Sheet.

Realized Gains and Losses. Net realized gains primarily result from the sale of equity securities associated with certain private finance investments, the sale of CMBS bonds and CDO bonds and preferred shares, and the realization of unamortized discount resulting from the sale and early repayment of private finance loans and commercial mortgage loans, offset by losses on investments. Net realized gains for the years ended December 31, 2006, 2005, and 2004, were as follows:

($ in millions)	**2006**	**2005**	**2004**
Realized gains	$557.5	$343.1	$ 267.7
Realized losses	(24.2)	(69.6)	(150.5)
Net realized gains	$533.3	$273.5	$ 117.2

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, 2006, 2005, and 2004, we reversed previously recorded unrealized appreciation or depreciation when gains or losses were realized as follows:

($ in millions)	**2006**	**2005[(1)]**	**2004**
Reversal of previously recorded net unrealized appreciation associated with realized gains	$(501.5)	$(108.0)	$(210.5)
Reversal of previously recorded net unrealized depreciation associated with realized losses	22.5	68.0	151.8
Total reversal	$(479.0)	$ (40.0)	$ (58.7)

(1) Includes the reversal of net unrealized appreciation of $6.5 million on the CMBS and CDO assets sold and the related hedges. The net unrealized appreciation recorded on these assets prior to their sale was determined on an individual security-by-security basis. The net gain realized upon the sale of $227.7 million reflects the total value received for the portfolio as a whole.

Realized gains for the years ended December 31, 2006, 2005, and 2004, were as follows:

($ in millions)

2006

Portfolio Company	Amount
Private Finance:	
Advantage Sales & Marketing, Inc.[1]	$434.4
STS Operating, Inc.	94.8
Oriental Trading Company, Inc.	8.9
Advantage Sales & Marketing, Inc.[2]	4.8
United Site Services, Inc.	3.3
Component Hardware Group, Inc.	2.8
Opinion Research Corporation	1.9
Nobel Learning Communities, Inc.	1.5
MHF Logistical Solutions, Inc.	1.2
The Debt Exchange, Inc.	1.1
Other	1.5
Total private finance	556.2
Commercial Real Estate:	
Other	1.3
Total commercial real estate	1.3
Total realized gains	$557.5

2005

Portfolio Company	Amount
Private Finance:	
Housecall Medical Resources, Inc.	$ 53.7
Fairchild Industrial Products Company	16.2
Apogen Technologies Inc.	9.0
Polaris Pool Systems, Inc.	7.4
MasterPlan, Inc.	3.7
U.S. Security Holdings, Inc.	3.3
Ginsey Industries, Inc.	2.8
E-Talk Corporation	1.6
Professional Paint, Inc.	1.6
Oriental Trading Company, Inc.	1.0
Woodstream Corporation	0.9
Impact Innovations Group, LLC	0.8
DCS Business Services, Inc.	0.7
Other	3.4
Total private finance	106.1
Commercial Real Estate:	

CMBS/CDO assets, net[3]	227.7
Other	9.3
Total commercial real estate	237.0
Total realized gains	$343.1

2004

Portfolio Company	Amount
Private Finance:	
The Hillman Companies, Inc.	$150.3
CorrFlex Graphics, LLC	25.7
Professional Paint, Inc.	13.7
Impact Innovations Group, LLC	11.1
The Hartz Mountain Corporation	8.3
Housecall Medical Resources, Inc.	7.2
International Fiber Corporation	5.2
CBA-Mezzanine Capital Finance, LLC	4.1
United Pet Group, Inc.	3.8
Oahu Waste Services, Inc.	2.8
Grant Broadcasting Systems II	2.7
Matrics, Inc.	2.1
SmartMail, LLC	2.1
Other	7.6
Total private finance	246.7
Commercial Real Estate:	
CMBS/CDO assets, net[3]	17.4
Other	3.6
Total commercial real estate	21.0
Total realized gains	$267.7

(1) Represents the realized gain on our majority equity investment only. See Private Finance above.

(2) Represents a realized gain on our minority equity investment only. See Private Finance above.

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

Realized losses for the years ended December 31, 2006, 2005, and 2004, were as follows:

($ in millions)

2006

Portfolio Company	Amount
Private Finance:	
Staffing Partners Holding Company, Inc.	$10.6
Acme Paging, L.P.	4.7
Cooper Natural Resources, Inc.	2.2
Aspen Pet Products, Inc.	1.6
Nobel Learning Communities, Inc.	1.4
Other	1.6
Total private finance	22.1
Commercial Real Estate:	
Other	2.1
Total commercial real estate	2.1
Total realized losses	$24.2

2005

Portfolio Company	Amount
Private Finance:	
Norstan Apparel Shops, Inc.	$18.5
Acme Paging, L.P.	13.8
E-Talk Corporation	9.0
Garden Ridge Corporation	7.1
HealthASPex, Inc.	3.5
MortgageRamp, Inc.	3.5
Maui Body Works, Inc.	2.7
Packaging Advantage Corporation	2.2
Other	3.7
Total private finance	64.0
Commercial Real Estate:	
Other	5.6
Total commercial real estate	5.6
Total realized losses	$69.6

2004

Portfolio Company	Amount
Private Finance:	
American Healthcare Services, Inc.	$ 32.9
The Color Factory, Inc.	24.5
Executive Greetings, Inc.	19.3
Sydran Food Services II, L.P.	18.2
Ace Products, Inc.	17.6
Prosperco Finanz Holding AG	7.5
Logic Bay Corporation	5.0
Sun States Refrigerated Services, Inc.	4.7
Chickasaw Sales & Marketing, Inc.	3.8
Sure-Tel, Inc.	2.3
Liberty-Pittsburgh Systems, Inc.	2.0
EDM Consulting, LLC	1.9
Pico Products, Inc.	1.7
Impact Innovations Group, LLC	1.7
Interline Brands, Inc.	1.3
Startec Global Communications Corporation	1.1
Other	2.7
Total private finance	148.2
Commercial Real Estate:	
Other	2.3
Total commercial real estate	2.3
Total realized losses	$ 150.5

Change in Unrealized Appreciation or Depreciation. For a discussion of our fair value methodology, see Change in Unrealized Appreciation or Depreciation included in the Comparison of the Three Months Ended March 31, 2007 and 2006 above.

Private Finance. We receive third-party valuation assistance from Duff & Phelps and Houlihan Lokey Howard and Zukin for our private finance portfolio. For the years ended December 31, 2006 and 2005, we received third-party valuation assistance as follows:

	2006				2005			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Number of private finance portfolio companies reviewed	81	105	78	78	80	89	72	36
Percentage of private finance portfolio reviewed at value	82.9%	86.5%	89.6%	87.0%	92.4%	89.3%	83.0%	74.5%

Professional fees for third-party valuation assistance for the years ended December 31, 2006, 2005, and 2004, were $1.5 million, $1.4 million, and $0.9 million, respectively.

Net Change in Unrealized Appreciation or Depreciation. Net change in unrealized appreciation or depreciation for the years ended December 31, 2006, 2005, and 2004, consisted of the following:

($ in millions)	2006[(1)]	2005[(1)]	2004[(1)]
Net unrealized appreciation or depreciation	$ 1.6	$ 502.1	$ (10.0)
Reversal of previously recorded unrealized appreciation associated with realized gains	(501.5)	(108.0)	(210.5)
Reversal of previously recorded unrealized depreciation associated with realized losses	22.5	68.0	151.8
Net change in unrealized appreciation or depreciation	$(477.4)	$ 462.1	$ (68.7)

(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.

Valuation of Business Loan Express, LLC. Our investment in BLX totaled $295.3 million at cost and $210.7 million at value at December 31, 2006, and $299.4 million at cost and $357.1 million at value at December 31, 2005. To determine the value of our investment in BLX at December 31, 2006, we performed numerous valuation analyses to determine a range of values including: (1) analysis of comparable public company trading multiples; (2) analysis of BLX s value assuming an initial public offering; (3) analysis of merger and acquisition transactions for financial services companies; (4) a discounted dividend analysis; and (5) adding BLX s net asset value (adjusted for certain discounts) to the value of BLX s business operations, which was determined by using a discounted cash flow model. In performing the valuation analyses at December 31, 2006, we considered the impact of various changes in BLX s business model due to the competitive environment for small business loans and BLX s newer non-SBA real estate lending products. We also considered BLX s regulatory issues and ongoing investigations when we performed our valuation as of December 31, 2006. (See Note 3, Portfolio of our Notes to the 2006 Consolidated Financial Statements.) The competitive SBA lending environment, our estimates of future profitability, and the impact of BLX s legal and regulatory matters resulted in a decrease in the value of our investment in BLX at December 31, 2006. We received valuation assistance from Duff & Phelps for our investment in BLX at December 31, 2006, 2005, and 2004.

With respect to the analysis of comparable public company trading multiples and the analysis of BLX s value assuming an initial public offering, we compute a median trailing and forward price earnings multiple to apply to BLX s pro-forma net income adjusted for certain capital structure changes that we believe would likely occur should the company be sold. Each quarter we evaluate which public commercial finance companies should be included in the comparable group. The comparable group at December 31, 2006, was made up of CIT Group, Inc., Financial Federal Corporation, GATX Corporation, and Marlin Business Services Corporation, which is consistent with the comparable group at December 31, 2005.

Our investment in BLX at December 31, 2006, was valued at $210.7 million. This fair value was within the range of values determined by our valuation analyses discussed above. Unrealized depreciation on our investment was $84.6 million at December 31, 2006. Net change in unrealized appreciation or depreciation included a net decrease of $142.3 million and $32.3 million for the years ended December 31, 2006 and 2004, respectively, and a net increase of $2.9 million for the year ended December 31, 2005.

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 145.6 million, 137.3 million, and 132.5 million for the years ended December 31, 2006, 2005, and 2004, respectively.

OTHER MATTERS

Regulated Investment Company Status. We have elected to be taxed as a regulated investment company under Subchapter M of the Code. As long as we qualify as a regulated investment company, we generally 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.

Dividends are paid to shareholders from taxable income. 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. See Dividends and Distributions below.

Dividends declared and paid by us in a year generally differ from taxable income for that year as such dividends may include the distribution of current year taxable income, the distribution of prior year taxable income carried over into and distributed in the current year, or returns of capital. We are generally required to distribute 98% of our taxable income during the year the income is earned to avoid paying an excise tax. If this requirement is not met, the Code imposes a nondeductible excise tax equal to 4% of the amount by which 98% of the current year s taxable income exceeds the distribution for the year. The taxable income on which an excise tax is paid is generally carried over and distributed to shareholders in the next tax year. Depending on the level of taxable income earned in a tax year, we may choose to carry over taxable income in excess of current year

distributions from such taxable income into the next tax year and pay a 4% excise tax on such income, as required. See Dividends and Distributions below.

In order to maintain our status as a regulated investment company and obtain regulated investment company tax benefits, we must, in general, (1) continue to qualify as a business development company; (2) derive at least 90% of our gross income from dividends, interest, gains from the sale of securities and other specified types of income; (3) meet asset diversification requirements as defined in the Code; and (4) timely distribute to shareholders at least 90% of our annual investment company taxable income as defined in the Code. We intend to take all steps necessary to continue to qualify as a regulated investment company. However, there can be no assurance that we will continue to qualify for such treatment in future years.

DIVIDENDS AND DISTRIBUTIONS

Total regular quarterly dividends to common shareholders were $2.42, $2.30, and $2.28 per common share for the years ended December 31, 2006, 2005, and 2004, respectively. An extra cash dividend of $0.05, $0.03 and $0.02 per common share was declared during 2006, 2005, and 2004, respectively, and was paid to shareholders on January 19, 2007, January 27, 2006, and January 28, 2005, respectively.

Dividends to common shareholders for the three months ended March 31, 2007 and 2006, were $95.8 million and $82.5 million, respectively, or $0.63 per common share for the first quarter of 2007 and $0.59 per common share for the first quarter of 2006. The Board of Directors has declared a dividend of $0.64 per common share for the second quarter of 2007.

Our Board of Directors reviews the dividend rate quarterly, and may adjust the quarterly dividend throughout the year. Dividends are declared considering our estimate of annual taxable income available for distribution to shareholders and the amount of taxable income carried over from the prior year for distribution in the current year. Our goal is to declare what we believe to be sustainable increases in our regular quarterly dividends. To the extent that we earn annual taxable income in excess of dividends paid 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 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 4% excise tax. We believe that carrying over excess taxable income into future periods may provide increased visibility with respect to taxable earnings available to pay the regular quarterly dividend.

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 changes in accrued and reinvested interest and dividends, which includes contractual payment-in-kind interest, and the amortization of discounts and fees. Cash collections of income resulting from contractual payment-in-kind interest or the amortization of discounts and fees generally occur upon the repayment of the loans or debt securities that include such items. Non-cash taxable income is reduced by non-cash expenses, such as realized losses and depreciation and amortization expense.

The summary of our taxable income and distributions of such taxable income for the years ended December 31, 2006, 2005, and 2004, is as follows:

($ in millions)	2006 (ESTIMATED)[1]	2005	2004
Taxable income[2]	$ 595.5	$ 445.0	$ 323.2
Taxable income earned in current year and carried forward for distribution in next year	(397.1)	(156.5)	(26.0)
Taxable income earned in prior year and carried forward and distributed in current year	156.5	26.0	2.1
Total dividends to common shareholders	$ 354.9	$ 314.5	$ 299.3

(1) Our taxable income for 2006 is an estimate and will not be finally determined until we file our 2006 tax return in September 2007. Therefore, the final taxable income and the taxable income earned in 2006 and carried forward for distribution in 2007 may be different than the estimate above. See Risk Factors above and Note 10, Dividends and Distributions and Taxes of our Notes to the 2006 Consolidated Financial Statements.

(2) See Note 10, Dividends and Distributions and Taxes of our Notes to the 2006 Consolidated Financial Statements for further information on the differences between net income for book purposes and taxable income.

Our estimated annual taxable income for 2006 exceeded our dividend distributions to shareholders for 2006 from such taxable income, and, therefore, we have carried over excess taxable income, which is currently estimated to be $397.1 million, for distribution to shareholders in 2007. Estimated excess taxable income for 2006 represents approximately $120.6 million of ordinary income and approximately $276.5 million of net long-term capital gains.

Dividends for 2007 will first be paid out of the excess taxable income carried over from 2006. Given our regular quarterly dividend payout, which for the first quarter of 2007 was $95.8 million, we expect that substantially all of the 2007 dividend payments will be made from excess 2006 taxable earnings. Given the significant amount of estimated excess taxable income carried forward from 2006 for distribution in 2007, we currently expect that our estimated annual taxable income for 2007 will be significantly in excess of our estimated dividend distributions to shareholders in 2007 from such taxable income, and, therefore, we expect to carry over excess taxable income for distribution to shareholders in 2008. We expect that we will generally be required to pay a 4% excise tax on the excess of 98% of our taxable income for 2007 over the amount of actual distributions from such taxable income in 2007. For the three months ended March 31, 2007, we recorded an excise tax of $3.6 million. Excise taxes are accrued based upon estimated excess taxable income as estimated taxable income is earned, therefore, the excise tax accrued to date in 2007 may be adjusted as appropriate in the remainder of 2007 to reflect changes in our estimate of the carry over amount and additional excise tax may be accrued during the remainder of 2007 as additional excess taxable income is earned, if any. Our ability to earn

the estimated annual taxable income for 2007 depends on many factors, including our ability to make new investments at attractive yields, the level of repayments in the portfolio, the realization of gains or losses from portfolio exits, and the level of operating expenses incurred. See Management s Discussion and Analysis of Financial Condition and Results of Operations and Risk Factors.

In addition to excess taxable income available to be carried over from 2006 for distribution in 2007, we currently estimate that we have cumulative deferred taxable income related to installment sale gains of approximately $220.7 million as of December 31, 2006, which is composed of cumulative deferred taxable income of $39.6 million as of December 31, 2005, and approximately $181.1 million for the year ended December 31, 2006. These gains have been recognized for financial reporting purposes in the respective years they were realized, but generally will be deferred for tax purposes until the notes or other amounts received from the sale of the related investments are collected in cash. The installment sale gains for 2006 are estimates and will not be finally determined until we file our 2006 tax return in September 2007. 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 three months ended March 31, 2007 and 2006, was $0.3 million and $0.2 million, respectively, and for the years ended December 31, 2006 and 2005 was $0.9 million and $0.6 million, respectively. This interest is included in interest expense in our Consolidated Statement of Operations.

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

At March 31, 2007, and December 31, 2006 and 2005, our liquidity portfolio (see below), 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)	**2007**	**2006**	**2005**
Liquidity portfolio (including money market and other securities: 2007-$205.0; 2006-$201.8; 2005-$100.0)	$ 205.0	$ 201.8	$ 200.3
Cash and investments in money market securities (including money market and other securities: 2007-$66.2; 2006-$0.4; 2005-$22.0)	$ 66.5	$ 2.1	$ 53.3
Total assets	$4,986.1	$4,887.5	$4,025.9
Total debt outstanding	$1,891.5	$1,899.1	$1,284.8
Total shareholders equity	$2,978.3	$2,841.2	$2,620.5
Debt to equity ratio(1)	0.64	0.67	0.49
Asset coverage ratio(2)	257%	250%	309%

(1) The debt to equity ratio adjusted for the liquidity portfolio was 0.57, 0.60, and 0.41 at March 31, 2007, and December 31, 2006 and 2005, respectively, which is calculated as (a) total debt less the value of the liquidity portfolio divided by (b) total shareholders equity.

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

Cash generated from the portfolio includes cash flow from net investment income and net realized gains and principal collections related to investment repayments or sales. Cash flow provided by our operating activities before new investment activity for the three

months ended March 31, 2007 and 2006, and for the years ended December 31, 2006, 2005, and 2004, was as follows:

($ in millions)	For the Three Months Ended March 31,		For the Year Ended December 31,		
	2007	2006	2006	2005	2004
Net cash provided by (used in) operating activities	$ 19.4	$ (17.7)	$ (597.5)	$ 116.0	$ (179.3)
Add: portfolio investments funded	170.2	647.9	2,257.8	1,668.1	1,472.4
Total cash provided by operating activities before new investments	$189.6	$630.2	$1,660.3	$1,784.1	$1,293.1

In addition to the net cash flow provided by our operating activities before funding investments, we have sources of liquidity through our liquidity portfolio and revolving line of credit as discussed below.

At March 31, 2007, and December 31, 2006 and 2005, the value and yield of the securities in the liquidity portfolio were as follows:

($ in millions)	2007		2006		2005	
	Value	Yield	Value	Yield	Value	Yield
U.S. Treasury bills	$		$		$100.3	4.3%
Money market securities	163.8	5.3%	161.2	5.3%	100.0	4.1%
Certificate of Deposit[1]	41.2	5.5%	40.6	5.6%		
Total	$205.0	5.3%	$201.8	5.3%	$200.3	4.2%

(1) The certificate of deposit at March 31, 2007, matures in June 2007.

The liquidity portfolio was established to provide a pool of liquid assets within our balance sheet. Our investment portfolio is primarily composed of private, illiquid assets for which there is no readily available market. We assess the amount held in and the composition of the liquidity portfolio throughout the year.

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 use our revolving line of credit facility as a means to bridge to long-term financing in the form of debt or equity capital, which may or may not result in temporary differences in the matching of estimated maturities. Availability on the revolving line of credit, net of amounts committed for standby letters of credit issued under the line of credit facility, was $888.0 million on March 31, 2007. 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 three months ended March 31, 2007 and 2006, we sold new equity of $93.8 million and $83.0 million, respectively, in public offerings. During the years ended December 31, 2006 and 2004, we sold new equity of $295.8 million and $70.3 million, respectively, in public offerings. We did not sell new equity in a public offering during the year ended December 31, 2005. During the years ended December 31, 2005 and 2004, we issued $7.2 million and $3.2 million, respectively, of our common stock as consideration for investments. In addition, shareholders equity increased by $5.8 million, $7.7 million, $27.7 million, $77.5 million, and $51.3 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 for the three months ended March 31, 2007 and 2006, and for the years ended December 31, 2006, 2005, and 2004, respectively.

We currently target a debt to equity ratio ranging between 0.50:1.00 to 0.70:1.00 because we believe that it is prudent to operate with a larger equity capital base and less leverage.

At March 31, 2007, and December 31, 2006 and 2005, we had outstanding debt as follows:

	2007				2006				2005			
($ in millions)	**Facility Amount**	**Amount Outstanding**	**Annual Interest Cost**[1]	**Annual Return to Cover Interest Payments**[2]	**Facility Amount**	**Amount Outstanding**	**Annual Interest Cost**[1]	**Annual Return to Cover Interest Payments**[2]	**Facility Amount**	**Amount Outstanding**	**Annual Interest Cost**[1]	**Annual Return to Cover Interest Payments**[2]
Notes payable and debentures:												
Privately issued unsecured notes payable	$1,041.5	$1,041.5	6.1%	1.3%	$1,041.4	$1,041.4	6.1%	1.3%	$1,164.5	$1,164.5	6.2%	1.8%
Publicly issued unsecured notes payable	850.0	850.0	6.7%	1.1%	650.0	650.0	6.6%	0.9%				%
SBA debentures [3]			%	%			%	%	28.5	28.5	7.5%	0.1%
Total notes payable and debentures	1,891.5	1,891.5	6.3%	2.4%	1,691.4	1,691.4	6.3%	2.2%	1,193.0	1,193.0	6.3%	1.9%
Revolving line of credit[6]	922.5		%[4]	0.1%	922.5	207.7	6.4%[4]	0.3%	772.5	91.8	5.6%[4]	0.2%
Total debt	$2,814.0	$1,891.5	6.5%[5]	2.5%	$2,613.9	$1,899.1	6.5%[5]	2.5%	$1,965.5	$1,284.8	6.5% [5]	2.1%

(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 that are recognized into interest expense over the contractual life of the respective borrowings, divided by (b) debt outstanding on the balance sheet date.

(2) The annual return to cover interest payments is calculated as the March 31, 2007, or December 31, 2006 or 2005, annualized cost of debt per class of financing outstanding divided by total assets at March 31, 2007, or December 31, 2006 or 2005, respectively.

(3) The SBA debentures were repaid in full during 2006.

(4) There were no amounts drawn on the revolving line of credit at March 31, 2007. The annual interest cost at December 31, 2006 and 2005, reflects the interest rate payable for borrowings under the revolving line of credit. In addition to the current interest rate payable, there were annual costs of commitment fees, other facility fees and amortization of debt financing costs of $3.8 million, $3.9 million and $3.3 million at

March 31, 2007, and December 31, 2006 and 2005, respectively.

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

(6) At March 31, 2007, $888.0 million remained unused and available on the revolving line of credit, net of amounts committed for standby letters of credit of $34.5 million issued under the credit facility.

Privately Issued Unsecured Notes Payable. We have privately issued unsecured long-term notes to institutional investors, primarily insurance companies. The notes have five- or seven-year maturities, with maturity dates beginning in 2008 and have fixed rates of interest. The notes require payment of interest only semi-annually, and all principal is due upon maturity. The notes may be prepaid in whole or in part, together with an interest premium, as stipulated in the note agreements.

We have issued five-year unsecured long-term notes denominated in Euros and Sterling for a total U.S. dollar equivalent of $15.2 million. The notes have fixed interest rates and have substantially the same terms as our other unsecured notes. The Euro notes require annual interest payments and the Sterling notes require semi-annual interest payments until maturity. Simultaneous with issuing the notes, we entered into a cross currency swap with a financial institution which fixed our interest and principal payments in U.S. dollars for the life of the debt.

On October 16, 2006, we repaid $150.0 million of unsecured long-term debt that matured. This debt had a fixed interest rate of 7.2%. We used cash generated from operations and borrowings on our revolving line of credit to repay this debt.

On May 1, 2006, we issued $50.0 million of unsecured long-term debt with a fixed interest rate of 6.8%. This debt matures in May 2013. The proceeds of this issuance were used to repay $25 million of 7.5% unsecured long-term debt that matured on May 1, 2006, and the remainder was used to fund new portfolio investments and for general corporate purposes.

On October 13, 2005, we issued $261.0 million of five-year and $89.0 million of seven-year unsecured long-term notes, primarily to insurance companies. The five-and seven-year notes have fixed interest rates of 6.2% and 6.3%, respectively, and have substantially the same terms as our existing unsecured long-term notes. We used a portion of the proceeds from the new long-term note issuance to repay $125.0 million of our existing unsecured long-term notes that matured on October 15, 2005, and had an annual weighted average interest cost of 8.3%. During the second quarter of 2005, we repaid $40.0 million of the unsecured notes payable.

Publicly Issued Unsecured Notes Payable. At March 31, 2007, we had outstanding publicly issued unsecured notes as follows:

($ in millions)	Amount	Maturity Date
6.625% Notes due 2011	$400.0	July 15, 2011
6.000% Notes due 2012	250.0	April 1, 2012
6.875% Notes due 2047	200.0	April 15, 2047
Total	$850.0	

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, as stipulated in the notes.

On March 28, 2007, we completed the issuance of $200.0 million of 6.875% Notes due 2047 for net proceeds of $193.0 million (net of underwriting discounts and estimated offering expenses). In April 2007, we issued additional notes, through an over-allotment option, totaling $30.0 million for net proceeds of $29.1 million (net of underwriting discounts and estimated offering expenses). The notes are listed on the New York Stock Exchange under the trading symbol AFC.

The 6.875% Notes due 2047 require payment of interest only quarterly, and all principal is due upon maturity. We may redeem these notes 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.

Small Business Administration Debentures. Through our small business investment company subsidiary, we had debentures payable to the Small Business Administration (SBA) with contractual maturities of ten years. The notes required payment of interest only semi-annually, and all principal was due upon maturity. For the years ended December 31, 2006 and 2005, we repaid $28.5 million and $49.0 million, respectively, of this outstanding debt. At December 31, 2006, we had no outstanding borrowings from the SBA. Allied Investments L.P., our Small Business Investment Company (SBIC) subsidiary, surrendered its SBIC license and on October 1, 2006, Allied Investments L.P. was merged into its parent, Allied Capital Corporation. Therefore, the SBA is no longer a source of debt capital for us.

Revolving Line of Credit. At March 31, 2007, we had an unsecured revolving line of credit with a committed amount of $922.5 million that expires on September 30, 2008. The revolving line of credit generally bears interest at a rate equal to (i) LIBOR (for the period we select) plus 1.05% or (ii) the higher of the Federal Funds rate plus 0.50% or the Bank of America N.A. prime rate. The revolving line of credit requires the payment of an annual commitment fee equal to 0.20% of the committed amount (whether used or unused). The revolving line of credit generally requires payments of interest at the end of each LIBOR interest period, but no less frequently than quarterly, on LIBOR based loans and monthly payments of interest on other loans. All principal is due upon maturity.

At March 31, 2007, there were no outstanding borrowings on our unsecured revolving line of credit. The amount available under the line at March 31, 2007, was $888.0 million, net of amounts committed for standby letters of credit of $34.5 million. Net repayments under the revolving line of credit for the three months ended March 31, 2007, were $207.7 million. Net borrowings under the revolving line of credit for the year ended December 31, 2006, were $116.0 million.

We have various financial and operating covenants required by the revolving line of credit and the privately issued unsecured notes payable outstanding at March 31, 2007. These covenants require us to maintain certain financial ratios, including debt to equity and interest coverage, and a minimum net worth. These credit facilities provide for customary events of default, including, but not limited to, payment defaults, breach of representations or covenants, cross-defaults, bankruptcy events, failure to pay judgments, attachment of our assets, change of control and the issuance of an order of dissolution. Certain of these events of default are subject to notice and cure periods or materiality thresholds. Our credit facilities limit our ability to declare dividends if we default under certain provisions. As of March 31, 2007, and December 31, 2006 and 2005, we were in compliance with these covenants.

We have certain financial and operating covenants that are required by the publicly issued unsecured notes payable, including that we will maintain a minimum ratio of 200% of total assets to total borrowings, as required by the Investment Company Act of 1940, as amended, while these notes are outstanding. At March 31, 2007, and December 31, 2006, we were in compliance with these covenants.

The following table shows our significant contractual obligations for the repayment of debt and payment of other contractual obligations as of March 31, 2007.

		Payments Due By Year					
($ in millions)	Total	2007	2008	2009	2010	2011	After 2011
Unsecured notes payable	$1,891.5	$	$153.0	$269.0	$408.0	$472.5	$589.0
Revolving line of credit[1]							
Operating leases	23.5	3.3	4.5	4.6	4.5	1.8	4.8
Total contractual obligations	$1,915.0	$3.3	$157.5	$273.6	$412.5	$474.3	$593.8

(1) At March 31, 2007, $888.0 million remained unused and available on the revolving line of credit, net of amounts committed for standby letters of credit of $34.5 million issued under the credit facility.

Off-Balance Sheet Arrangements

In the ordinary course of business, we have issued guarantees and have extended standby letters of credit through financial intermediaries on behalf of certain portfolio companies. We have generally issued guarantees of debt, rental and lease obligations. Under these arrangements, we would be required to make payments to third-party beneficiaries if the portfolio companies were to default on their related payment obligations. The following table shows our guarantees and standby letters of credit that may have the effect of creating, increasing, or accelerating our liabilities as of March 31, 2007.

		Amount of Commitment Expiration Per Year					
($ in millions)	Total	2007	2008	2009	2010	2011	After 2011
Guarantees	$194.5	$0.3	$ 3.0	$184.9	$	$4.4	$1.9
Standby letters of credit[1]	34.5	4.0	30.5				
Total commitments[2]	$229.0	$4.3	$33.5	$184.9	$	$4.4	$1.9

(1) Standby letters of credit are issued under our revolving line of credit that expires in September 2008. Therefore, unless a standby letter of credit is set to expire at an earlier date, we have assumed that the standby letters of credit will expire contemporaneously with the expiration of our line of credit in September 2008.

(2) Our most significant commitments relate to our investment in Business Loan Express, LLC (BLX), which commitments totaled $202.4 million at March 31, 2007. At March 31, 2007, we guaranteed 50% of the outstanding total obligations on BLX s revolving line of credit for a total guaranteed amount of $179.4 million and we had also provided four standby letters of credit totaling $20.0 million in connection with four term securitizations completed by BLX. In addition, we have agreed to purchase the $3.0 million of Class A equity interests purchased by the chief executive officer of BLX at fair value in the event that BLX amends or otherwise restructures its existing senior credit facility or he is terminated for any reason. See Private Finance, Business Loan Express, LLC above for further discussion.

In addition, we had outstanding commitments to fund investments totaling $410.8 million at March 31, 2007. See Portfolio and Investment Activity Outstanding Commitments above. We intend to fund these commitments and prospective investment opportunities with existing cash, through cash flow from operations before new investments, through borrowings under our line of credit or other long-term debt agreements, or through the sale or issuance of new equity capital.

CRITICAL ACCOUNTING POLICIES

The consolidated financial statements are based on the selection and application of critical accounting policies, which require management to make significant estimates and

assumptions. Critical accounting policies are those that are both important to the presentation of our financial condition and results of operations and require management s most difficult, complex, or subjective judgments. Our critical accounting policies are those applicable to the valuation of investments, certain revenue recognition matters and certain tax matters as discussed below.

Valuation of Portfolio Investments. As a business development company, we invest in illiquid securities including debt and equity securities of companies and CDO and CLO bonds and preferred shares/income notes. Our investments may be subject to certain restrictions on resale and generally have no established trading market. We value substantially all of our investments at fair value as determined in good faith by the Board of Directors in accordance with our valuation policy. We determine fair value to be the amount for which an investment could be exchanged in an orderly disposition over a reasonable period of time between willing parties other than in a forced or liquidation sale. Our valuation policy considers the fact that no ready market exists for substantially all of the securities in which we invest. Our valuation policy is intended to provide a consistent basis for determining the fair value of the portfolio. We will record unrealized depreciation on investments when we believe that an investment has become impaired, including where collection of a loan or realization of an equity security is doubtful, or when the enterprise value of the portfolio company does not currently support the cost of our debt or equity investments. Enterprise value means the entire value of the company to a potential buyer, including the sum of the values of debt and equity securities used to capitalize the enterprise at a point in time. We will record unrealized appreciation if we believe that the underlying portfolio company has appreciated in value and/ or our equity security has also appreciated in value. The value of investments in publicly traded securities is determined using quoted market prices discounted for restrictions on resale, if any.

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

Loans and Debt Securities. For loans and debt securities, fair value generally approximates cost unless the borrower s enterprise value, overall financial condition or other factors lead to a determination of fair value at a different amount. The value of loan and debt securities may be greater than our cost basis if the amount that would be repaid on the loan or debt security upon the sale of the portfolio company is greater than our cost basis.

When we receive nominal cost warrants or free equity securities (nominal cost equity), we allocate our cost basis in our investment between debt securities and nominal cost equity at the time of origination. At that time, the original issue discount basis of the nominal cost equity is recorded by increasing the cost basis in the equity and decreasing the cost basis in the related debt securities.

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

owned by us depending on such company s capital requirements. Loan origination fees, original issue discount, and market discount are capitalized and then amortized into interest income using 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. Prepayment premiums are recorded on loans and debt securities when received.

Equity Securities. Our equity securities in portfolio companies for which there is no liquid public market are valued at fair value based on the enterprise value of the portfolio company, which is determined using various factors, including cash flow from operations of the portfolio company, 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. 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.

The value of our equity securities in public companies for which market quotations are readily available is based on the closing public market price on the balance sheet date. Securities that carry certain restrictions on sale are typically valued at a discount from the public market value of the security.

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

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

We recognize interest income on the preferred shares/income notes using the effective interest method, based on the anticipated yield and 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 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. CDO and CLO bonds have stated interest rates.

Net Realized Gains or Losses and Net Change in Unrealized Appreciation or Depreciation. Realized gains or losses are measured by the difference between the net

proceeds from the repayment or sale and the cost basis of the investment without regard to unrealized appreciation or depreciation previously recognized, and include investments charged off during the year, net of recoveries. Net change in unrealized appreciation or depreciation 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 and deposits of proceeds from sales of borrowed Treasury securities, and depreciation on accrued interest and dividends receivable and other assets where collection is doubtful.

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 are generally recognized as income as the services are rendered.

Federal and State Income Taxes and Excise Tax. We intend to comply with the requirements of the Internal Revenue Code (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 for the year. 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.

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. We utilize our revolving line of credit as a means to bridge to long-term financing. Our long-term fixed-rate investments are financed primarily with long-term fixed-rate debt and equity. We may use interest rate risk management techniques in an effort to limit our exposure to interest rate fluctuations. Such techniques may include various interest rate hedging activities to the extent permitted by the 1940 Act. We have analyzed the potential impact of changes in interest rates on interest income net of interest expense.

Assuming that the balance sheet as of March 31, 2007, 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 1% over a one year horizon. Although management believes that this measure is indicative of our sensitivity to interest rate changes, it does not adjust for potential changes in credit quality, size and composition of the assets on the balance sheet and other business developments that could affect net increase in net assets resulting from operations, or net income. Accordingly, no assurances can be given that actual results would not differ materially from the potential outcome simulated by this estimate.

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

RECENT DEVELOPMENTS

On May 15, 2007, our stockholders approved an amendment to our Amended Stock Option Plan (the Plan) to increase the number of shares authorized for issuance under the Plan to 37,175,000.

In addition, on May 15, 2007, the Compensation Committee of the Board of Directors granted options to purchase 6,375,150 shares of our common stock. This included options to purchase 186,000 shares granted to William L. Walton, Chairman and Chief Executive Officer, and options to purchase 139,500 shares granted to each of Joan M. Sweeney, Chief Operating Officer, Penni F. Roll, Chief Financial Officer, Michael J. Grisius, Managing Director, and John D. Shulman, Managing Director.

Pursuant to an exemptive order from the Securities and Exchange Commission dated September 8, 1999, our non-officer directors are eligible to receive option grants under the Plan. Pursuant to this order, each non-officer director will receive options to purchase 5,000 shares each year on the date of the Annual Meeting of Stockholders. On May 15, 2007, options to purchase a total of 60,000 shares were granted to non-officer directors. These option grants are included in the option grants described above.

See Compensation of Directors and Executive Officers for further information.

SENIOR SECURITIES

Information about our senior securities is shown in the following tables as of December 31 for the years indicated in the table, unless otherwise noted. The report of our independent registered public accounting firm on the senior securities table as of December 31, 2006, is attached as an exhibit to the registration statement of which this prospectus is a part. The indicates information which the SEC expressly does not require to be disclosed for certain types of senior securities.

Class and Year	Total Amount Outstanding Exclusive of Treasury Securities[1]	Asset Coverage Per Unit[2]	Involuntary Liquidating Preference Per Unit[3]	Average Market Value Per Unit[4]
Privately Issued Unsecured Notes Payable				
1997	$ 0	$ 0	$	N/A
1998	180,000,000	2,734		N/A
1999	419,000,000	2,283		N/A
2000	544,000,000	2,445		N/A
2001	694,000,000	2,453		N/A
2002	694,000,000	2,704		N/A
2003	854,000,000	3,219		N/A
2004	981,368,000	2,801		N/A
2005[5]	1,164,540,000	3,086		N/A
2006[5]	1,041,400,000	2,496		N/A
2007 (as of March 31, unaudited)[6]	1,041,516,000	2,575		N/A
Publicly Issued Unsecured Notes Payable				
1997	$ 0	$ 0	$	N/A
1998	0	0		N/A
1999	0	0		N/A
2000	0	0		N/A
2001	0	0		N/A
2002	0	0		N/A
2003	0	0		N/A
2004	0	0		N/A
2005[5]	0	0		N/A
2006[5]	650,000,000	2,496		$ 1,000
2007 (as of March 31, unaudited)[6]	850,000,000	2,575		$ 771
Revolving Lines of Credit				
1997	$ 38,842,000	$ 2,215	$	N/A
1998	95,000,000	2,734		N/A
1999	82,000,000	2,283		N/A
2000	82,000,000	2,445		N/A
2001	144,750,000	2,453		N/A
2002	204,250,000	2,704		N/A
2003	0	0		N/A
2004	112,000,000	2,801		N/A
2005	91,750,000	3,086		N/A
2006	207,750,000	2,496		N/A
2007 (as of March 31, unaudited)	0	0		N/A

Class and Year	Total Amount Outstanding Exclusive of Treasury Securities[1]	Asset Coverage Per Unit[2]	Involuntary Liquidating Preference Per Unit[3]	Average Market Value Per Unit[4]
Small Business Administration Debentures[7]				
1997	$ 54,300,000	$2,215	$	N/A
1998	47,650,000	2,734		N/A
1999	62,650,000	2,283		N/A
2000	78,350,000	2,445		N/A
2001	94,500,000	2,453		N/A
2002	94,500,000	2,704		N/A
2003	94,500,000	3,219		N/A
2004	77,500,000	2,801		N/A
2005	28,500,000	3,086		N/A
2006	0	0		N/A
2007 (as of March 31, unaudited)	0	0		N/A
Overseas Private Investment Corporation Loan				
1997	$ 8,700,000	$2,215	$	N/A
1998	5,700,000	2,734		N/A
1999	5,700,000	2,283		N/A
2000	5,700,000	2,445		N/A
2001	5,700,000	2,453		N/A
2002	5,700,000	2,704		N/A
2003	5,700,000	3,219		N/A
2004	5,700,000	2,801		N/A
2005	0	0		N/A
2006	0	0		N/A
2007 (as of March 31, unaudited)	0	0		N/A
Auction Rate Reset Note				
1997	$ 0	$ 0	$	N/A
1998	0	0		N/A
1999	0	0		N/A
2000	76,598,000	2,445		N/A
2001	81,856,000	2,453		N/A
2002	0	0		N/A
2003	0	0		N/A
2004	0	0		N/A
2005	0	0		N/A
2006	0	0		N/A
2007 (as of March 31, unaudited)	0	0		N/A
Master Repurchase Agreement and Master Loan and Security Agreement				
1997	$225,821,000	$2,215	$	N/A
1998	6,000,000	2,734		N/A
1999	23,500,000	2,283		N/A
2000	0	0		N/A
2001	0	0		N/A
2002	0	0		N/A
2003	0	0		N/A
2004	0	0		N/A
2005	0	0		N/A
2006	0	0		N/A
2007 (as of March 31, unaudited)	0	0		N/A

Class and Year	Total Amount Outstanding Exclusive of Treasury Securities(1)	Asset Coverage Per Unit(2)	Involuntary Liquidating Preference Per Unit(3)	Average Market Value Per Unit(4)
Senior Note Payable(8)				
1997	$20,000,000	$2,215	$	N/A
1998	0	0		N/A
1999	0	0		N/A
2000	0	0		N/A
2001	0	0		N/A
2002	0	0		N/A
2003	0	0		N/A
2004	0	0		N/A
2005	0	0		N/A
2006	0	0		N/A
2007 (as of March 31, unaudited)	0	0		N/A
Redeemable Cumulative Preferred Stock(7)(9)				
1997	$ 1,000,000	$ 217	$100	N/A
1998	1,000,000	267	100	N/A
1999	1,000,000	225	100	N/A
2000	1,000,000	242	100	N/A
2001	1,000,000	244	100	N/A
2002	1,000,000	268	100	N/A
2003	1,000,000	319	100	N/A
2004	0	0		N/A
2005	0	0		N/A
2006	0	0		