ALLIED CAPITAL CORP
Form 497
February 25, 2002

PROSPECTUS SUPPLEMENT
(To Prospectus dated December 19, 2001)

Filed Pursuant to Rule 497 Registration
Statement No. 333-67336

784,555 Shares
COMMON STOCK

All of the 784,555 shares of the common stock, par value $.0001 per share, of Allied Capital Corporation are being issued and sold by us to an institutional investor at negotiated purchase prices for total offering proceeds to the Company of $20 million.

These negotiated purchase prices, per share, are equal to the Volume Weighted Average Price on the New York Stock Exchange, as reported by Bloomberg L.P. using the AQR function for the shares (the Average Trading Price), less a discount of 3% (the Purchase Price), for each of the fourteen trading days during the period from February 4, 2002 to February 22, 2002 (the Investment Period).

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

(i) the allocation of the purchaser s proposed aggregate investment of $20 million on a pro rata basis over the Investment Period; and

(ii) the purchase, on each day during the Investment Period on which the Average Trading Price exceeds $22.00 (the Threshold Price) or on which the Average Trading Price is below the Threshold Price and the purchaser chooses to purchase shares at the Threshold Price, of the maximum number of whole shares at the Purchase Price.

This results in the purchase of a total of 784,555 shares at an average purchase price per share of $25.49.

Our common stock is traded on the New York Stock Exchange under the symbol ALD. On February 22, 2002, the last reported sales price for the common stock was $27.00.

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

Please read this prospectus supplement, and the accompanying prospectus, before investing, and keep it for future reference. It contains important information about the Company. To learn more about the Company, you may want to look at the Statement of Additional Information dated December 19, 2001 (known as the SAI). For a free copy of the SAI, contact us at Allied Capital Corporation, 1919 Pennsylvania Avenue, N.W., Washington, DC 20006, 1-888-253-0512. We have filed the SAI with the U.S. Securities and Exchange Commission and have incorporated it by reference into the prospectus. The SAI s table of contents appears on page B-1 of the prospectus. The Commission maintains an Internet website (http://www.sec.gov) that contains the SAI, material incorporated by reference and other information about the Company.

You should review the information including the risk of leverage, set forth under Risk Factors on page 8 of the prospectus, before investing in common stock of the Company.

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

February 22, 2002

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

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Information contained or incorporated by reference in this prospectus supplement, and the prospectus, may contain forward-looking statements which can be identified by the use of forward-looking terminology such as may, will, expect, intend, anticipate, estimate, or continue or the negative thereof or other variations thereon or comparable terminology. The matters described in Risk Factors in the prospectus and certain other factors noted throughout this prospectus supplement and the prospectus, and in any exhibits to the registration statement of which this prospectus supplement and the prospectus are a part, constitute cautionary statements identifying important factors with respect to any such forward-looking statements, including certain risks and uncertainties, that could cause actual results to differ materially from those in such forward-looking statements. In this prospectus supplement and the prospectus, unless otherwise indicated, the Company , we , us or our refer to Allied Capital Corporation and its subsidiaries.

FEES AND EXPENSES

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

Shareholder Transaction Expenses	
Privately negotiated transaction (as a percentage of offering price)(1)	3.0%
Dividend reinvestment plan fees(2)	None
Annual Expenses (as a percentage of consolidated net assets attributable to common shares)(3)	
Operating expenses(4)	3.4%
Interest payments on borrowed funds(5)	5.1%
Total annual expenses(6)	8.5%

(1) The discount with respect to the shares sold by the Company in this offering is the only sales load paid in connection with this offering.
(2) The expenses of the Company s DRIP plan are included in Operating expenses. The Company has no cash purchase plan. The participants in the DRIP plan will bear a pro rata share of brokerage commissions incurred with respect to open market purchases, if any. See Dividend Reinvestment Plan in the prospectus.
(3) Consolidated net assets attributable to common shares equals net assets (*i.e.,* total assets less total liabilities and preferred stock) at September 30, 2001.
(4) Operating expenses represent the estimated operating expenses of the Company for the year ending December 31, 2001 excluding interest on indebtedness. This percentage for the year ended December 31, 2000 was 3.4%.
(5) The Interest payments on borrowed funds represent estimated interest payments for the year ending December 31, 2001. The Company had outstanding borrowings of $924.5 million at September 30, 2001. This percentage for the year ended December 31, 2000 was 5.6%. See Risk Factors in the prospectus.
(6) Total annual expenses as a percentage of consolidated net assets attributable to common stock are higher than the total annual expenses percentage would be for a company that is not leveraged. The Company borrows money to leverage its net assets and to increase its total assets. The Securities and Exchange Commission requires that Total annual expenses percentage be calculated as a percentage of *net* assets, rather than the total assets, including assets that have been funded with borrowed money. If the Total annual expenses percentage were calculated instead as a percentage of consolidated total assets, Total annual expenses for the Company would be 4.9% of consolidated total assets.

Example

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

	1 Year	3 Years	5 Years	10 Years
You would pay the following expenses on a $1,000 investment, assuming a 5% annual return	$113	$280	$447	$868

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

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

RECENT DEVELOPMENTS

Operating Results

For the year ended December 31, 2001, the Company reported net income of $200.7 million, or $2.16 per share, an 11% increase on a per share basis as compared to earnings of $143.1 million, or $1.94 per share, for 2000. For the three months ended December 31, 2001, the Company reported net income of $42.9 million, or $0.43 per share, as compared to net income of $42.3 million, or $0.52 per share, for the three months ended December 31, 2000. Net income varies substantially from quarter to quarter due to the varied timing of events that result in net realized and unrealized gains or losses. As a result, quarterly comparisons of net income may not be meaningful.

Net operating income before net realized and unrealized gains or losses was $179.1 million, or $1.92 per share for 2001, a 25% increase on a per share basis as compared to net operating income of $112.7 million, or $1.53 per share, for 2000. For the fourth quarter of 2001, net operating income before net realized and unrealized gains or losses totaled $53.0 million, or $0.53 per share, a 26% increase on a per share basis as compared to fourth quarter 2000 net operating income of $34.7 million, or $0.42 per share.

Net realized and unrealized gains totaled $21.3 million, or $0.23 per share, for 2001 as compared to $30.4 million, or $0.41 per share, for 2000. For the year ended December 31, 2001, the Company recognized realized gains of $10.1 million and realized losses of $9.4 million.

During 2001, the Company invested a total of $680.3 million. After total repayments of $74.5 million, asset sales of $130.0 million and valuation changes during the year, total assets increased to $2.46 billion at December 31, 2001, a 33% increase over total assets of $1.85 billion at December 31, 2000. Shareholders equity increased 31% to $1.35 billion at December 31, 2001 from $1.03 billion at December 31, 2000. Net asset value per share at December 31, 2001 was $13.57, a 12% increase over the net asset value per share of $12.11 at December 31, 2000.

For the year ended December 31, 2001, the Company s total return to shareholders was 35%, including reinvestment of dividends and share price appreciation during the year. The annual return on average assets was 9% and the annual return on average equity was 17% for the year ended December 31, 2001.

For 2001, private finance investments totaled $287.7 million and commercial real estate investments totaled $392.6 million. For the fourth quarter of 2001, total new loans and investments were $170.7 million. At December 31, 2001, the overall weighted average yield on the Company s portfolio was 14.3%, as compared to 14.1% at December 31, 2000.

Private Finance

The private finance portfolio totaled $1.60 billion at December 31, 2001. The debt portion of this portfolio, which totaled $1.11 billion at December 31, 2001, had a weighted average yield of 14.8%, as compared to 14.6% at December 31, 2000. During the fourth quarter of 2001, the Company invested a total of $60.9 million in its core private finance business. Significant new private finance investments during the fourth quarter of 2001 included:

$15.0 million in subordinated debt to support the acquisition of HSCA by MedAssets HSCA, a healthcare outsourcing company;

$13.0 million in subordinated debt and equity capital in a recapitalization of Elmhurst Consulting LLC, an implementation-focused supply chain consulting firm;

$11.0 million of subordinated debt with warrants to recapitalize Advantage Mayer, Inc., one of the country s leading regional food brokers; and

$5.1 million in preferred stock to fund the growth of Foresite Towers LLC, a developer of communications towers.

CMBS Investing

During the year ended December 31, 2001, the Company s commercial real estate finance group invested $390.4 million in non-investment grade commercial mortgage-backed securities (CMBS) in nine separate transactions. For the year ended December 31, 2001, the Company sold a total of $124.5 million of CMBS. During the fourth quarter of 2001, the Company invested $109.6 million in CMBS in three separate transactions.

At December 31, 2001, the Company s portfolio of CMBS, all of which was acquired directly from the original issuers, totaled $582.6 million, or 24% of total assets, and had a weighted average yield to maturity of 14.8%. Because the Company has acquired its CMBS investments at an approximate discount of 50% from the face amount of the bonds, the unamortized discount on the CMBS portfolio at December 31, 2001 totaled $611.9 million.

From time to time, the Company will purchase lower yielding BB bonds in anticipation of future opportunities to sell such bonds at a premium. In February 2002, the Company completed the sale of $122.6 million of BB+, BB and BB- bonds that were purchased during 2001, 2000 and 1999.

Liquidity and Capital Resources

During 2001, the Company raised $286.9 million of new equity in eight separate placements. In addition, the Company obtained additional unsecured long-term debt of $150 million. The Company also expanded its committed unsecured revolving credit facility to $497.5 million, of which $352.8 million was available at December 31, 2001.

At December 31, 2001, the Company had a weighted average cost of debt of 7.0%. At December 31, 2001, the Company had regulatory asset coverage of 245% and the ratio of debt to equity was 0.75 to 1. The Company is required to maintain regulatory asset coverage of at least 200%.

Portfolio Quality and Valuation

The Company employs a grading system to monitor the quality of its portfolio. Grade 1 is for those investments from which a capital gain is expected. Grade 2 is for investments performing in accordance with plan. Grade 3 is for investments that require closer monitoring; however, no loss of interest or principal is expected. Grade 4 is for investments for which some loss of contractually due interest is expected, but no loss of principal is expected. Grade 5 is for investments for which full loss of interest and some loss of principal is expected, and the loan is marked down to net realizable value.

At December 31, 2001, the portfolio of Grade 1 investments totaled $603.3 million, or 26% of the total portfolio at value; Grade 2 investments totaled $1.55 billion, or 67% of the total portfolio; Grade 3 investments totaled $79.5 million, or 3% of the total portfolio; Grade 4 investments totaled $44.5 million, or 2% of the total portfolio; and Grade 5 investments totaled $48.5 million, or 2% of the total portfolio. Included in Grade 4 and 5 investments are assets totaling $6.6 million that are secured by commercial real estate.

For the total investment portfolio, loans greater than 90 days past due were $39.1 million at value at December 31, 2001, or 2% of the total portfolio. Included in this category are loans valued at

$14.1 million that are secured by commercial real estate. At December 31, 2001, greater than 30-day delinquencies in the underlying collateral pool related to the CMBS portfolio were 0.45%.

Quarterly Dividend

The Company increased its regular quarterly dividend to $0.53 per share for the first quarter of 2002. The dividend is payable on March 28, 2002 to shareholders of record on March 15, 2002.

For 2001, the Company paid total dividends of $2.01 per share, a 10.4% increase over total dividends of $1.82 per share in 2000. The Company s dividend is paid from taxable income. The Board determines the dividend, based on annual estimates of taxable income, which differs from book income due to both timing and absolute differences in income and expense recognition. Changes in unrealized appreciation and depreciation have no impact on the Company s taxable income.

SUMMARY FINANCIAL INFORMATION

(In thousands, except per share amounts)	At December 31, 2001	At December 31, 2000
ASSETS		
Portfolio at Value:		
Private finance	$1,595,072	$1,282,467
Commercial real estate finance	734,518	505,534
Total Portfolio at Value	2,329,590	1,788,001
Cash and cash equivalents	889	2,449
Other assets	130,234	63,367
Total Assets	$2,460,713	$1,853,817
LIABILITIES and SHAREHOLDERS EQUITY		
Liabilities:		
Debt	$1,020,806	$786,648
Other liabilities	80,784	30,477
	1,101,590	817,125
Preferred stock	7,000	7,000
Common shareholders equity	1,352,123	1,029,692

Total Liabilities and Shareholders Equity	$2,460,713	$1,853,817
Net asset value per common share	$13.57	$12.11
Common shares outstanding at end of year	99,607	85,057

(In thousands, except per share amounts)	3 Months Ended December 31		12 Months Ended December 31	
	2001	**2000**	**2001**	**2000**
	(unaudited)			
Interest and Related Portfolio Income:				
Interest and dividend income	$66,742	$52,539	$240,464	$182,307
Premiums from loan dispositions	434	5,386	2,504	16,138
Fees and other income	15,490	3,810	46,142	13,144
Total Interest and Related Portfolio Income	82,666	61,735	289,110	211,589
Expenses:				
Interest	17,130	15,767	65,104	57,412
Employee	7,387	6,519	29,656	26,025
Administrative	5,133	4,724	15,299	15,435

Total Operating Expenses	29,650	27,010	110,059	98,872
Net Operating Income Before Net Realized and Unrealized Gains (Losses)	53,016	34,725	179,051	112,717
Net Realized and Unrealized Gains (Losses):				
Net realized gains (losses)	(7,678)	(7,572)	661	15,523
Net unrealized gains (losses)	(2,860)	15,128	20,603	14,861
Total Net Realized and Unrealized Gains (Losses)	(10,538)	7,556	21,264	30,384
Net Income Before Income Taxes	42,478	42,281	200,315	143,101
Income tax benefit	412		412	
Net Increase in Net Assets Resulting From Operations	$42,890	$42,281	$200,727	$143,101

Diluted net operating income per share	$0.53	$0.42	$1.92	$1.53
Diluted earnings per share	$0.43	$0.52	$2.16	$1.94
Weighted average shares outstanding diluted	100,052	81,612	93,003	73,472

Certain reclassifications have been made to the 2000 balances to conform to the 2001 financial statement presentation.

USE OF PROCEEDS

The net proceeds from the sale of the shares, after deducting estimated expenses of this offering, are approximately $19.95 million. We intend to use the net proceeds from selling shares to finance our Company s growth and for general corporate purposes, which may include investment in private growth companies, purchase of commercial mortgage-backed securities and acquisitions. We may also repay a portion of our revolving line of credit.

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

PLAN OF DISTRIBUTION

All of the 784,555 shares of common stock, par value $0.0001 per share, that we are offering by this prospectus supplement and the accompanying prospectus are being issued and sold to an institutional investor at negotiated purchase prices for total offering proceeds to the Company of $20 million.

These negotiated purchase prices, per share, are equal to the Volume Weighted Average Price on the New York Stock Exchange, as reported by Bloomberg L.P. using the AQR function for the shares (the Average Trading Price), less a discount of 3.0% (the Purchase Price), for each of the fourteen trading days during the period from February 4, 2002 to February 22, 2002 (the Investment Period). The total number of shares offered hereby equals the aggregate number of shares resulting from:

(i) the allocation of the purchaser s proposed aggregate investment of $20 million on a pro rata basis over the Investment Period, and

(ii) the purchase, on each day during the Investment Period on which the Average Trading Price exceeds $22.00 (the Threshold Price) or on which the Average Trading Price is below the Threshold Price and the purchaser chooses to purchase shares at the Threshold Price, of the maximum number of whole shares at the Purchase Price. This results in the purchase of a total of 784,555 shares at an average purchase price per share of $25.49.

The net offering proceeds to us, after deduction of estimated offering expenses of approximately $50,000, will be approximately $19.95 million.

PROSPECTUS

$300,000,000

Common Stock
Preferred Stock
Debt Securities

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

To learn more about the Company, you may want to look at the Statement of Additional Information dated December 19, 2001 (known as the SAI). For a free copy of the SAI, contact us at:

Allied Capital Corporation
1919 Pennsylvania Avenue, N.W.
Washington, DC 20006
1-888-253-0512

The Company has filed the SAI with the U.S. Securities and Exchange Commission and has incorporated it by reference into this prospectus. The SAI s table of contents appears on page 82 of this prospectus.

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

Our common stock is traded on the New York Stock Exchange under the symbol ALD. As of December 19, 2001, the last reported sales price on the New York Stock Exchange for the common stock was $25.24.

We may offer, from time to time, up to $300,000,000 of our common stock, par value $0.0001 per share, preferred stock, or debt securities in one or more offerings. All shares of common stock, preferred stock, and debt securities that are offered under this prospectus are collectively referred to herein as the Securities.

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

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

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

You should review the information including the risk of leverage, set forth under Risk Factors on page 8 of this prospectus before investing in Securities of the Company.

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

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

December 19, 2001

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

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PROSPECTUS SUMMARY

The following summary contains basic information about this offering. It may not contain all the information that is important to an investor. For a more complete understanding of this offering, we encourage you to read this entire document and the documents to which we have referred.

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

THE COMPANY *(Page 14)*

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

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

Our investment portfolio includes:

- long-term unsecured loans with equity features,
- equity investments in middle-market companies, which may or may not constitute a controlling equity interest,
- commercial mortgage-backed securities, and
- commercial mortgage loans.

We identify loans and investments through our numerous relationships with:

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

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

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

We are an internally managed diversified closed-end management investment company that has elected to be regulated as a business development company (BDC) under the Investment Company Act of 1940, as amended (1940 Act). Our investment objective is to achieve current income and capital gains. We seek to achieve our investment objective by investing in growing businesses in a variety of industries throughout the United States. As a BDC, we are required to meet regulatory tests, the most significant relating to its investments and borrowings. A BDC is required to invest at least 70% of its assets in private or thinly traded public, U.S.-based companies. A BDC must maintain a coverage ratio of assets to senior securities of at least 200%. See Business Certain Government Regulations.

We are quoted on the New York Stock Exchange and trade under the symbol ALD.

THE OFFERING *(Page 80)*

We may offer, from time to time, up to $300,000,000 of our Securities, on terms to be determined at the time of offering.

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

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

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

USE OF PROCEEDS *(Page 14)*

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

DISTRIBUTIONS *(Page 15)*

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

DIVIDEND REINVESTMENT PLAN *(Page 74)*

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

PRINCIPAL RISK FACTORS *(Page 8)*

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

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

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

Also, we are subject to certain risks associated with investing in non-investment grade CMBS, valuing our portfolio, changing interest rates, accessing additional capital, fluctuating quarterly results, and operating in a regulated environment. In addition, the loss of pass-through tax treatment could have a material adverse effect on our total return, if any.

CERTAIN ANTI-TAKEOVER PROVISIONS *(Page 77)*

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

FEES AND EXPENSES

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

Shareholder Transaction Expenses	
Sales load (as a percentage of offering price)(1)	%
Dividend reinvestment plan fees(2)	None
Annual Expenses (as a percentage of consolidated net assets attributable to common stock)(3)	
Operating expenses(4)	3.4%
Interest payments on borrowed funds(5)	5.1%
Total annual expenses(6)	8.5%

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

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

(3) Consolidated net assets attributable to common stock equals net assets (*i.e.*, total assets less total liabilities and preferred stock) at September 30, 2001.

(4) Operating expenses represent the estimated operating expenses of the Company for the year ending December 31, 2001 excluding interest on indebtedness. This percentage for the year ended December 31, 2000 was 3.4%.

(5) The Interest payments on borrowed funds represents the estimated interest payments of the Company for the year ending December 31, 2001. The Company had outstanding borrowings of $924.5 million at September 30, 2001. This percentage for the year ended December 31, 2000 was 5.6%. See Risk Factors.

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

Example

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

	1 Year	3 Years	5 Years	10 Years
You would pay the following expenses on a $1,000 investment, assuming a 5.0% annual return	$85	$254	$425	$852

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

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

SELECTED CONSOLIDATED FINANCIAL DATA

You should read the consolidated financial information below with the Consolidated Financial Statements and Notes thereto included in this prospectus. Financial information for the years ended December 31, 2000, 1999, 1998, 1997 and 1996 has been derived from audited financial statements. On December 31, 1997, the Company consummated a merger of five predecessor companies. The selected financial data and all other information in this prospectus, unless otherwise indicated, reflects the operations of the Company with all periods restated as if the predecessor companies had merged as of the beginning of the earliest period presented. Quarterly financial information is derived from unaudited financial data, but in the opinion of management, reflects all adjustments (consisting only of normal recurring adjustments) which are necessary to present fairly the results for such interim periods. Interim results at and for the nine months ended September 30, 2001 are not necessarily indicative of the results that may be expected for the year ending December 31, 2001. **See Management s Discussion and Analysis of Financial Condition and Results of Operations on page 16 for more information.**

(In thousands, except per share data)	**Nine Months Ended September 30,**		**Year Ended December 31,**				
	2001	**2000**	**2000**	**1999**	**1998**	**1997(7)**	**1996(7)**
	(Unaudited)						
Operating Data:							
Interest and related portfolio income:							
Interest and dividends	$173,722	$129,768	$182,307	$121,112	$80,281	$86,882	$77,541
Premiums from loan dispositions	2,070	10,752	16,138	14,284	5,949	7,277	4,241
Post-merger gain on securitization of commercial mortgage loans					14,812		
Fees and other income	30,652	9,334	13,144	5,744	5,696	3,246	3,155
Total interest and related portfolio income	206,444	149,854	211,589	141,140	106,738	97,405	84,937

Expenses:

Interest	47,974	41,645	57,412	34,860	20,694	26,952	20,298
Employee(1)	22,269	19,506	26,025	22,889	18,878	10,258	8,774
Administrative	10,166	10,711	15,435	12,350	11,921	8,970	8,289
Merger			5,159				
Total operating expenses	80,409	71,862	98,872	70,099	51,493	51,339	37,361
Net operating income before net realized and unrealized gains	126,035	77,992	112,717	71,041	55,245	46,066	47,576

Net realized and unrealized gains:

Net realized gains	8,339	23,095	15,523	25,391	22,541	10,704	19,155
Net unrealized gains (losses)	23,463	(267)	14,861	2,138	1,079	7,209	(7,412)
Total net realized and unrealized gains	31,802	22,828	30,384	27,529	23,620	17,913	11,743
Income before minority interests and income taxes	157,837	100,820	143,101	98,570	78,865	63,979	59,319
Minority interests				1,231	2,427		
Income tax expense			787	1,444	1,945		

Net increase in net assets resulting from operations	$157,837	$100,820	$143,101	$98,570	$78,078	$61,304	$54,947

Per Share:

Diluted net operating income per common share(2)	$1.39	$1.10	$1.53	$1.18	$1.06	$1.04	$1.01
Diluted earnings per common share	$1.74	$1.42	$1.94	$1.64	$1.50	$1.24	$1.17
Dividends per common share(3)	$1.50	$1.36	$1.82	$1.60	$1.43	$1.71	$1.23
Weighted average common shares outstanding diluted(4)	90,864	70,777	73,472	60,044	51,974	49,251	46,733

(in thousands, except per share data)	At September 30,	At December 31,				
	2001	2000	1999	1998	1997(7)	1996(7)
	(Unaudited)					
Balance Sheet Data:						
Portfolio at value	$2,174,373	$1,788,001	$1,228,497	$807,119	$703,331	$612,411
Portfolio at cost	2,128,726	1,765,895	1,222,901	803,479	697,030	618,319
Total assets	2,266,833	1,853,817	1,290,038	856,079	807,775	713,360
Total debt outstanding(5)	924,484	786,648	592,850	334,350	347,663	274,997
Preferred stock issued to SBA(5)	7,000	7,000	7,000	7,000	7,000	7,000
Shareholders equity	1,300,237	1,029,692	667,513	491,358	420,060	402,134
Shareholders equity per common share (NAV)	$13.42	$12.11	$10.20	$8.79	$8.07	$8.34
Common shares outstanding at period end(4)	96,921	85,057	65,414	55,919	52,047	48,238

	Nine Months Ended September 30,		Year Ended December 31,				
	2001	2000	2000	1999	1998	1997(7)	1996(7)
	(Unaudited)						
Other Data:							
Portfolio investments funded	$509,578	$640,196	$901,545	$751,871	$524,530	$364,942	$283,295
Loan repayments	52,016	117,940	154,112	145,706	138,081	233,005	179,292
Loan sales(6)	129,980	151,834	280,244	198,368	81,013	53,912	27,715
Realized gains	9,942	24,664	28,604	31,536	25,757	15,804	30,417
Realized losses	(1,603)	(1,569)	(13,081)	(6,145)	(3,216)	(5,100)	(11,262)

(1) Employee expenses include formula and cut-off awards of $91,000 and $4,797,000 for the nine months ended September 30, 2001 and 2000, respectively, and $6,183,000, $6,753,000 and $7,049,000 for the years ended December 31, 2000, 1999 and 1998, respectively. See Management s Discussion and Analysis of Financial Condition and Results of Operations Results of Operations Comparison of Nine Months Ended September 30, 2001 and 2000 and Fiscal Years Ended December 31, 2000, 1999 and 1998.

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

(3)

Distributions are based on taxable income, which differs from income for financial reporting purposes. In 1997, Allied Capital Corporation (old) distributed $0.34 per common share representing the 844,914 shares of Allied Capital Lending Corporation distributed in conjunction with the merger. The distribution resulted in a partial return of capital. Also in conjunction with the merger, the Company distributed $0.17 per common share representing the undistributed earnings of the predecessor companies at December 31, 1997.

(4) Excludes 259,983 common shares held in the deferred compensation trust at or for the nine months ended September 30, 2000, and 234,977, 516,779 and 810,456 common shares held in the deferred compensation trust at or for the years ended December 31, 2000, 1999, and 1998, respectively. There were no shares held in the deferred compensation trust at or during the nine months ended September 30, 2001.

(5) See Senior Securities on page 37 for more information regarding the Company s level of indebtedness.

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

(7) Our current business and investment portfolio resulted from the merger of five affiliated companies on December 31, 1997. The companies that merged were Allied Capital Corporation (old), Allied Capital Corporation II, Allied Capital Advisers, Inc. (Advisers), Allied Capital Commercial Corporation and Allied Capital Lending Corporation. The five companies are referred to as the predecessor companies. The selected consolidated financial data reflects the operations of the company as if the predecessor companies were merged for these periods.

(in thousands, except per share data)	2001 Qtr 3	2001 Qtr 2	2001 Qtr 1	2000 Qtr 4	2000 Qtr 3	2000 Qtr 2	2000 Qtr 1
	(unaudited)			(unaudited)			
Quarterly Data:							
Total interest and related portfolio income	$72,634	$68,739	$65,071	$61,735	$55,992	$49,965	$43,897
Net operating income before net realized and unrealized gains	44,189	42,118	39,728	34,725	30,719	24,700	22,573
Net increase in net assets resulting from operations	59,703	46,106	52,028	42,281	36,449	34,790	29,581
Diluted net operating income per share	$0.47	$0.46	$0.46	$0.43	$0.40	$0.35	$0.34
Diluted earnings per common share	0.63	0.51	0.60	0.52	0.48	0.50	0.45
Dividends declared per common share	0.51	0.50	0.49	0.46	0.46	0.45	0.45
Net asset value per common share(1)	13.42	12.79	12.26	12.11	11.56	10.96	10.44

[Additional columns below]

[Continued from above table, first column(s) repeated]

(in thousands, except per share data)	1999 Qtr 4	1999 Qtr 3	1999 Qtr 2	1999 Qtr 1
	(unaudited)			
Quarterly Data:				
Total interest and related portfolio income	$42,278	$37,998	$33,186	$27,678
Net operating income before net realized and unrealized gains	21,319	19,273	16,619	13,830
Net increase in net assets resulting from operations	30,925	26,944	22,121	18,580
Diluted net operating income per share	$0.34	$0.31	$0.28	$0.24
Diluted earnings per common share	0.49	0.44	0.38	0.33
Dividends declared per common share	0.40	0.40	0.40	0.40
Net asset value per common share(1)	10.20	9.66	9.17	9.00

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

WHERE YOU CAN FIND ADDITIONAL INFORMATION

We have filed with the Commission a registration statement on Form N-2 together with all amendments and related exhibits under the Securities Act of 1933, as amended (the Securities Act). The registration statement contains additional information about us and the registered securities being offered by this prospectus. You may inspect the registration statement and the exhibits without charge at the Securities and Exchange Commission at 450 Fifth Street, NW, Washington, DC 20549. You may obtain copies from the Commission at prescribed rates.

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

RISK FACTORS

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

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

Economic Recessions or Downturns Could Impair Our Portfolio Companies and Harm Our Operating Results. Although our investment strategy focuses on investment in companies in less cyclical industries, some of the companies in which we have made or will make investments may be susceptible to economic slowdowns or recessions. An economic slowdown may impact the ability of a company to engage in a liquidity event or repay our loans. These conditions could lead to financial losses in our portfolio and a decrease in our revenues, net income and assets. See Business Private Finance.

On September 11, 2001, a terrorist attack occurred at the World Trade Center in New York City and the Pentagon in Washington, D.C. This incident has had pervasive negative impacts on several U.S. industries and on the U.S. economy in general. While we were not directly impacted by the event, we believe that we could be impacted indirectly. The indirect impacts may include our need to provide a deferral of interest payments to certain portfolio companies that may be affected by the resulting economic slow down and a decrease in the pace of our investment activity.

Our business of making private equity investments and positioning them for liquidity events also may be impacted by current and future market conditions. The absence of a robust bank lending environment 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 amount and timing of gains realized on our investments. We cannot assure you that the events of September 11, 2001 and the reaction to them may not have other material and adverse implications for us and for the market in general.

Our Financial Results Could Be Negatively Affected if BLX Fails to Perform as Expected. Business Loan Express, Inc. (BLX) is our largest portfolio investment. Our financial results could be negatively affected if BLX, as a portfolio company, fails to perform as expected. At September 30, 2001, the investment totaled $225.5 million, or 10% of total assets. In addition, as controlling shareholder of BLX, we have provided an unconditional guaranty to BLX s credit facility lenders in an amount equal to 50% of BLX s total obligations on its $117.5 million unsecured revolving credit facility. The amount we have guaranteed at September 30, 2001 was $50.3 million. This guaranty can only be called in the event of a default by BLX.

Our Borrowers May Default on Their Payments. We make unsecured, subordinated loans and invest in equity securities, which may involve a higher degree of repayment risk. We primarily invest in and lend to companies that may have limited financial resources and that may be unable to obtain financing from traditional sources. Numerous factors may affect a borrower s ability to repay its loan, including the failure to meet its business plan, a downturn in its industry or negative economic conditions. Deterioration in a borrower s financial condition and prospects may be accompanied by deterioration in any collateral for the loan.

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

Our Private Finance Investments May Not Produce Capital Gains. Private finance investments are typically structured as debt securities with a relatively high fixed rate of interest and with an equity feature such as conversion rights, warrants or options. As a result, private finance investments generate interest income from the time they are made, and may also produce a realized gain from an accompanying equity feature. We cannot be sure that our portfolio will generate a current return or capital gains.

Investments in Non-Investment Grade Commercial Mortgage-Backed Securities May Be Illiquid and May Have a Higher Risk of Default. The commercial mortgage-backed securities (CMBS) in which we invest are non-investment grade, which means that nationally recognized statistical rating organizations rate them below the top four investment-grade rating categories (i.e., AAA through BBB), and are sometimes referred to as junk bonds. The non-investment grade CMBS tend to be less liquid, may have a higher risk of default and may be more difficult to value. Non-investment grade securities usually provide a higher yield than do investment-grade bonds, but with the higher return comes greater risk. Non-investment grade securities are considered speculative, and their capacity to pay principal and interest in accordance with the terms of their issue is not ensured.

Our Portfolio Investments are Recorded at Fair Value as Determined by the Board of Directors in Absence of Readily Ascertainable Public Market Values. Pursuant to the requirements of the Investment Company Act of 1940 (1940 Act), the Board of Directors is required to value each asset quarterly, and we are required to carry our portfolio at fair value as determined by the Board of Directors. Since there is typically no public market for the loans and equity securities of the companies in which we make investments or the CMBS that we purchase, our Board of Directors estimates the fair value of these investments pursuant to a written valuation policy and a consistently applied valuation process. Unlike banks, we are not permitted to provide a general reserve for anticipated loan losses; we are instead required by the 1940 Act to specifically value each individual investment and record an unrealized loss for an asset that we believe has become impaired. Without a readily ascertainable market value, the estimated value of our portfolio of investments may differ significantly from the values that would be placed on the portfolio if there existed a ready market for the investments. We adjust quarterly the valuation of our portfolio to reflect the Board of Directors estimate of the current fair value of each investment in our portfolio. Any changes in estimated value are recorded in the Company s statement of operations as Net unrealized gains (losses).

We Borrow Money Which Magnifies the Potential for Gain or Loss on Amounts Invested and May Increase the Risk of Investing in Our Company. We borrow from, and issue senior debt securities to, banks, insurance companies and other lenders. Lenders of these senior securities have fixed dollar claims on our consolidated assets that are superior to the claims of our common shareholders. Borrowings, also known as leverage, magnify the potential for gain or loss on amounts invested and, therefore, increase the risks associated with investing in our securities. If the value of our consolidated assets increases, then leveraging would cause the net asset value attributable to the Company s common stock to increase more sharply than it would have had we not leveraged. Conversely, if the value of our consolidated assets decreases, leveraging would cause net asset value to decline more sharply than it otherwise would have had we not leveraged. Similarly, any increase in our consolidated income in excess of consolidated interest payable on the borrowed funds would cause our net income to increase more than it would without the leverage, while any decrease in our consolidated income would cause net income to decline more sharply than it would have had we not borrowed. Such a decline could negatively affect our ability to make common stock dividend payments. Leverage is generally considered a speculative investment technique.

At September 30, 2001, the Company had $924.5 million of outstanding indebtedness, bearing a weighted annual interest cost of 7.1%. In order for us to cover these annual interest payments on indebtedness, we must achieve annual returns on our assets of at least 2.9%.

Illustration. The following table illustrates the effect of leverage on returns from an investment in our common stock assuming various annual returns, net of expenses. The calculations in the table below are hypothetical and actual returns may be higher or lower than those appearing below.

Assumed Return on the Company s Portfolio

(net of expenses)

	-20%	-10%	-5%	0%	5%	10%	20%
Corresponding return to shareholder(1)	-40.0%	-22.5%	-13.8%	-5.1%	3.6%	12.3%	29.8%

(1) The calculation assumes (i) $2,266.8 million in total assets, (ii) an average cost of funds of 7.1%, (iii) $924.5 million in debt outstanding and (iv) $1,300.2 million of shareholders equity.

We May Not Borrow Money Unless We Maintain Asset Coverage for Indebtedness of at Least 200% Which May Affect Returns to Shareholders. We must maintain asset coverage for a class of senior security representing indebtedness of at least 200%. Our ability to achieve our investment objective may depend in part on our continued ability to maintain a leveraged capital structure by borrowing from banks or other lenders on favorable terms. There can be no assurance that we will be able to maintain such leverage. If asset coverage declines to less than 200%, we may be required to sell a portion of our investments when it is disadvantageous to do so. As of September 30, 2001, our asset coverage for senior indebtedness was 255%.

Changes in Interest Rates May Affect Our Cost of Capital and Net Operating Income. Because we borrow money to make investments, our net operating income is dependent upon the difference between the rate at which we borrow funds and the rate at which we invest these funds. As a result, there can be no assurance that a significant change in market interest rates will not have a material adverse effect on our portfolio income. In periods of sharply rising interest rates, our cost of funds would increase, which would reduce our net operating income before net realized and unrealized gains. However, there would be no effect on the return, if any, that could be generated from our equity interests. We use a combination of long-term and short-term borrowings and equity capital to finance our investing activities. The Company utilizes its short-term credit facilities only as a means to bridge to long-term financing. Our long-term fixed-rate investments are financed primarily with long-term fixed-rate debt and equity. We may use interest rate risk management techniques in an effort to limit our exposure to interest rate fluctuations. Such techniques may include various interest rate hedging activities to the extent permitted by the 1940 Act.

Because We Must Distribute Income, We Will Continue to Need Additional Capital to Grow. We will continue to need capital to fund incremental growth in our investments. Historically, we have borrowed from financial institutions and have issued equity securities. A reduction in the availability of new capital could limit our ability to grow. We must distribute at least 90% of our taxable net operating income excluding net realized long-term capital gains to our stockholders to maintain our regulated investment company (RIC) status. As a result such earnings will not be available to fund investment originations. We expect to continue to borrow from financial institutions and sell additional equity securities. If we fail to obtain funds from such sources or from other sources to fund our investments, it could limit our ability to grow, which could have a material adverse effect on the value of the Company s common stock. In addition, as a business development company (BDC), we are generally required to maintain a ratio of at least 200% of total assets to total borrowings, which may restrict our ability to borrow in certain circumstances.

Loss of Pass-Through Tax Treatment Would Substantially Reduce Net Assets and Income Available for Dividends. We have operated the Company so as to qualify to be taxed as a RIC under Subchapter M of the Internal Revenue Code of 1986, as amended (Code). If we meet source of income, diversification and distribution requirements, the Company qualifies for effective pass-through tax treatment. The Company would cease to qualify for such pass-through tax treatment if it were unable to comply with these requirements, or if it ceased to qualify as a BDC under the 1940 Act. We also could be subject to a 4% excise tax and/or corporate level income tax if we fail to make required distributions as a RIC. If the Company ceased to qualify as a RIC, the Company would become subject to federal income tax as if it were an ordinary corporation, which would substantially reduce our net assets and the amount of income available for distribution to our shareholders.

We Operate in a Competitive Market for Investment Opportunities. We compete for investments with many other companies and individuals, some of whom have greater resources than we do. Increased competition would make it more difficult for us to purchase or originate investments at attractive prices. As a result of this competition, sometimes we may be precluded from making otherwise attractive investments.

Changes in the Law or Regulations that Govern the Company Could Have a Material Impact on the Company or Our Operations. We are regulated by the Securities and Exchange Commission and the SBA. In addition, changes in the laws or regulations that govern BDCs, RICs, real estate investment trusts (REITs) and SBICs may significantly affect our business. Any change in the law or regulations that govern our business could have a material impact on the Company or its operations. Laws and regulations may be changed from time to time, and the interpretations of the relevant laws and regulations also are subject to change.

Quarterly Results May Fluctuate and May Not Be Indicative of Future Quarterly Performance. The Company s quarterly operating results could fluctuate and therefore, you should not rely on quarterly results to be indicative of the Company s performance in future quarters. Factors that could cause quarterly operating results to fluctuate include, among others, variations in the investment origination volume and fee income earned, variation in timing of prepayments, variations in and the timing of the recognition of realized and unrealized gains or losses, the degree to which we encounter competition in our markets and general economic conditions.

Disclosure Regarding Forward-Looking Statements

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

THE COMPANY

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

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

USE OF PROCEEDS

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

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

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

PRICE RANGE OF COMMON STOCK AND DISTRIBUTIONS

Our common stock is traded on the New York Stock Exchange under the symbol ALD. The following table lists the high and low closing sales prices for the Company s common stock. On December 19, 2001, the last reported closing sale price of the common stock was $25.24 per share.

	Closing Sale Price(1)	
	High	**Low**
Year ended December 31, 1999		
First Quarter	$20.250	$16.500
Second Quarter	24.000	17.000
Third Quarter	23.813	20.250
Fourth Quarter	23.125	16.750
Year ended December 31, 2000		
First Quarter	$19.688	$16.063
Second Quarter	18.688	16.563
Third Quarter	21.125	17.438
Fourth Quarter	21.375	18.500
Year ending December 31, 2001		
First Quarter	$24.436	$20.125
Second Quarter	25.400	19.570
Third Quarter	24.830	21.500
Fourth Quarter (through December 19, 2001)	26.00	21.57

(1) Prior to June 6, 2001, the Company s common stock was traded on the Nasdaq National Market under the symbol ALLC. The closing sale prices listed are as reflected on the respective exchanges for the periods presented.

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

We pay quarterly dividends to stockholders of our common stock. The amount of our quarterly dividends is determined by the Board of Directors. The Company s Board has established a dividend policy to review the dividend rate quarterly and to adjust the quarterly dividend rate as the Company s earnings momentum builds. See Management s Discussion and Analysis of Financial Condition and Results of Operations Equity Capital and

Dividends and Tax Status. We cannot assure that we will achieve investment results or maintain a tax status that will permit any particular level of dividend payment.

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

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

MANAGEMENT S DISCUSSION AND ANALYSIS

OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The information contained in this section should be read in conjunction with the Selected Consolidated Financial Data and the Company s Consolidated Financial Statements and Notes thereto.

OVERVIEW

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

The Company s portfolio composition at September 30, 2001, and December 31, 2000, 1999 and 1998 was as follows:

	At September 30, 2001	At December 31, 2000	1999	1998
Private Finance	71%	72%	53%	48%
Commercial Real Estate Finance	29%	28%	42%	44%
Small Business Finance	%	%	5%	8%

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

PORTFOLIO AND INVESTMENT ACTIVITY

Total portfolio investment activity and yields as of and for the three and nine months ended September 30, 2001 and 2000 and as of and for the years ended December 31, 2000, 1999 and 1998 were as follows:

	At and for the Three Months Ended September 30,		At and for the Nine Months Ended September 30,		At and for the Years Ended December 31,		
($ in millions)	2001	2000	2001	2000	2000	1999	1998
Portfolio at Value	$2,174.4	$1,638.2	$2,174.4	$1,638.2	$1,788.0	$1,228.5	$807.1
Investments Funded	$209.5	$237.8	$509.6	$640.2	$901.5	$751.9	$524.5

Repayments	$7.9	$59.1	$52.0	$117.9	$154.1	$145.7	$138.0
Sales	$57.5	$34.7	$130.0	$151.8	$280.2	$198.4	$304.4
Yield	14.1%	13.9%	14.1%	13.9%	14.1%	13.0%	12.5%

Private Finance

Private finance investment activity and yields as of and for the three and nine months ended September 30, 2001 and 2000 and as of and for the years ended December 31, 2000, 1999 and 1998 were as follows:

	At and for the Three Months Ended Sept. 30,		At and for the Nine Months Ended Sept. 30,		At and for the Years Ended December 31,		
($ in millions)	2001	2000	2001	2000	2000	1999	1998
Portfolio at Value	$1,539.3	$967.5	$1,539.3	$967.5	$1,282.5	$647.0	$388.6
Investments Funded	$112.7	$148.5	$226.8	$387.6	$600.9	$346.7	$236.0
Repayments	$5.8	$49.6	$29.8	$88.8	$117.7	$87.5	$41.3
Yield	14.5%	14.6%	14.5%	14.6%	14.6%	14.2%	14.6%

The private finance portfolio increased 20% from December 31, 2000 to September 30, 2001, and increased 98% and 67% during the years ended December 31, 2000 and 1999, respectively. In addition to the $226.8 million of funded investments for the nine months ended September 30, 2001, the Company invested an additional $31.7 million in portfolio companies through receipt of payment in-kind securities. Buyout and private finance activity across the industry has been slow during the first nine months of 2001 largely due to credit tightening among senior lenders. Since equity-focused buyout firms generally need both senior and subordinated debt to leverage private equity investments, buyout activity has been reduced due to a lower level of activity in the senior bank market, and in particular the senior syndicated loan market. As a result, the Company s investment activity for the nine months ended September 30, 2001 has been at a slower pace than the comparable period for the prior year.

During the third quarter, the Company closed the controlled buyout of SunSource Inc. on September 26, 2001. Pursuant to the merger agreement signed on June 18, 2001, the Company paid $10.375 per SunSource common share, or $71.5 million, in cash for the outstanding common equity of SunSource. On September 28, 2001, SunSource announced that it completed the sale of its STS business unit. Pursuant to this sale, SunSource returned $15.0 million in cash to the Company, reducing the Company s cost basis. The Company s cost basis in the common stock of SunSource after the return of capital from the STS sale and the capitalization of deal costs was $58.6 million at September 30, 2001. The SunSource investment has been structured to provide for a current return to be earned through interest on debt and management/ consulting fees for services provided by the Company. In addition, during the third quarter of 2001, the Company earned investment banking fees of $2.8 million for the acquisition of SunSource and the sale of STS, earned a syndication fee of $1.6 million for the syndication of SunSource s senior credit facilities and realized a gain of $2.5 million from the sale of warrants in SunSource prior to the controlled buyout transaction. As part of the STS sale, the Company invested $3.2 million in the new STS.

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

	For the Years Ended December 31,		
	2000	1999	1998
New investment characteristics:			
Number of investments	34	27	19
Average investment size (millions)	$14.0	$12.4	$10.6
Average current yield	14.7%	13.6%	13.3%
Average portfolio company revenue (millions)	$153.5	$86.9	$81.3
Average portfolio company years in business	36	29	22

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

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

During 2000, the Company acquired BLC Financial Services, Inc. in a going private transaction, which thereafter changed its name to Business Loan Express, Inc. (BLX). The Company s investment in BLX is included in the private finance portfolio. See Small Business Finance discussion for more details below.

During the second quarter of 2000, the Company began an initiative to invest in and strategically partner with select private equity funds focused on venture capital investments. The strategy for these fund investments is to provide solid investment returns and build strategic relationships with the fund managers and their portfolio companies. The Company believes that it will have opportunities to co-invest with the funds as well as finance their portfolio companies as they mature.

The Company believes that the fund investment strategy is an effective means of participating in private equity investing through a diverse pooled investment portfolio. The fund concept allows the Company to participate in a pooled investment return without exposure to the risk of any single investment. Since the beginning of 2000, the Company has committed a total of $44.5 million to eight private equity funds. The committed amount is expected to be invested over the next three years. The Company funded $0.4 million, $3.5 million and $7.0 million of this commitment for the three and nine months ended September 30, 2001 and for the year ended December 31, 2000, respectively.

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Commercial Real Estate Finance

Commercial real estate finance investment activity and yields as of and for the three and nine months ended September 30, 2001 and 2000 and as of and for the years ended December 31, 2000, 1999 and 1998 were as follows:

	At and for the Three Months Ended September 30,		At and for the Nine Months Ended September 30,		At and for the Years Ended December 31,		
($ in millions)	2001	2000	2001	2000	2000	1999	1998
Portfolio at Value	$635.1	$600.0	$635.1	$600.0	$505.5	$520.0	$355.0
Investments Funded	$96.8	$52.6	$282.8	$143.7	$149.0	$288.7	$214.6
Repayments	$2.1	$6.5	$22.2	$20.8	$24.8	$51.5	$92.5
Sales	$57.5	$1.6	$130.0	$53.1	$151.7	$86.1	$256.9
Yield	13.5%	13.2%	13.5%	13.2%	13.1%	12.3%	10.4%

The commercial real estate finance portfolio increased 26% from December 31, 2000 to September 30, 2001, and decreased 3% and increased 46% for the years ended December 31, 2000 and 1999, respectively. During 1998, the Company reduced its commercial mortgage loan origination activity for its own portfolio due to declining interest rates and began to sell its loans to other lenders. Then, beginning in the fourth quarter of 1998, the Company began to take advantage of a unique market opportunity to acquire non-investment grade commercial mortgage-backed securities (CMBS) at significant discounts from the face amount of the bonds. Turmoil in the capital markets at that time created a lack of liquidity for the traditional buyers of non-investment grade bonds. As a result, yields on these collateralized bonds increased, thus providing an attractive investment opportunity. The Company believes that CMBS is an attractive asset class because of the yields that can be earned on a security that is secured by commercial mortgage loans. The Company has opportunistically purchased CMBS since the fourth quarter of 1998. The Company plans to continue its CMBS investment activity, however, in order to maintain a balanced portfolio the Company expects that purchased CMBS will continue to represent approximately 20% to 25% of total assets during 2001. The Company s CMBS investment activity level will be dependent upon its ability to purchase CMBS at attractive yields.

The Company purchases CMBS at an approximate discount of 50% from the face amount of the bonds. During the third quarter of 2001, the Company purchased $96.8 million in CMBS with a face value of $171.1 million and a weighted average yield to maturity of 15.0% after assuming a 1% loss rate on the underlying collateral mortgage pool. During the nine months ended September 30, 2001 the Company purchased $256.1 million in CMBS with a face value of $449.0 million. During the first quarter of 2001, the Company also purchased $24.6 million in non-investment grade securities related to a collateralized debt issuance secured by CMBS and investment grade real estate investment trust bonds. The weighted average yield to maturity on purchases made during the first nine months of 2001 is 15.0% after assuming a 1% loss rate on the underlying collateral mortgage pool. During 2000 and 1999, the Company purchased $124.3 million and $245.9 million in CMBS with a face amount of $244.6 million and $507.9 million and a weighted average yield to maturity of 14.7% and 14.6% after assuming a 1% loss rate on the underlying collateral mortgage pool, respectively.

As a part of the Company s strategy to maximize its return on equity capital, the Company sold CMBS bonds rated BB+, BB and BB- during the third quarter of 2001, 19

the first nine months of 2001 and the fourth quarter of 2000 totaling $55.6 million, $124.5 million and $98.7 million, respectively. These bonds had an effective yield of 10.4%, 10.3% and 11.5%, and were sold for $56.7 million, $126.8 million and $102.5 million, respectively, resulting in realized gains on the sales. The sale of these lower-yielding bonds increased the Company s overall liquidity. The effective yield on the Company s remaining purchased CMBS portfolio at September 30, 2001 was 15.2%, after assuming a 1% loss on the entire underlying mortgage loan pool. At September 30, 2001 and December 31, 2000 and 1999, the value of the purchased CMBS portfolio was $472.1 million, $311.3 million and $277.7 million and the unamortized discount was $510.3 million, $364.9 million and $291.5 million, respectively.

The original principal balance of the underlying pool of the approximately 3,300 loans that are collateral for the Company s CMBS had underwritten loan to value (LTV) and underwritten debt service coverage ratios (DSCR) as follows:

Loan to Value Ranges	**$**	**%**
	($ in millions)	
Less than 60%	$2,060.4	11%
60-65%	1,663.9	9%
65-70%	2,834.0	16%
70-75%	5,838.7	33%
75-80%	5,332.0	30%
Greater than 80%	214.3	1%
	$17,943.3	100%
Weighted average LTV	69.7%	

Debt Service Coverage Ratio Ranges	**$**	**%**
	($ in millions)	
Greater than 2.00	$556.6	3%
1.76-2.00	551.8	3%
1.51-1.75	2,046.3	11%
1.26-1.50	10,393.0	58%

1.00-1.25	4,395.6	25%
	$17,943.3	100%
Weighted average DSCR	1.40	

The Company has been liquidating much of its whole commercial mortgage loan portfolio so that it can redeploy the proceeds into higher yielding assets and for the three and nine months ended September 30, 2001, the Company sold $1.9 million and $7.6 million, respectively of commercial mortgage loans. For the years ended December 31, 2000 and 1999, the Company sold $53.1 million and $86.1 million of commercial mortgage loans, respectively. At September 30, 2001, the Company s whole commercial real estate loan portfolio had been reduced to $86.2 million from $106.4 million at December 31, 2000.

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

Small Business Finance

On December 31, 2000, the Company acquired 95% of BLC Financial Services, Inc. in a going private buyout transaction for $95.2 million. The Company issued approximately 4.1 million shares, or $86.1 million of new equity, and paid $9.1 million in cash to acquire BLC, which is now BLX.

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

At September 30, 2001, BLX had a 3-year $117.5 million revolving credit facility (BLX Credit Facility), which was increased to $124.0 million in October 2001. As the controlling shareholder of BLX, the Company has provided an unconditional guaranty to the BLX Credit Facility lenders in an amount of up to 50% of the total obligations (consisting of principal, accrued interest and other fees) of BLX on the line of credit. The amount guaranteed by the Company at September 30, 2001 was $50.3 million. This guaranty can be called by the lenders only in the event of a default by BLX. BLX was in compliance with the terms of the BLX Credit Facility at September 30, 2001.

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

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

Allied Capital Express loan origination activity for 2000 and 1999 increased due to the opening of new regional office locations and from opportunities created by the Company s Internet site launched in the fall of 1999. Loans in the Allied Capital Express program were originated for sale; therefore, the increase in loan sales was the result of the increase in originations. In addition, beginning in 1999, the Company began to sell 90% of the unguaranteed portion of SBA 7(a) loans through a structured finance agreement with a commercial paper conduit. Allied Capital Express targeted small commercial real estate loans that were, in many cases, originated in conjunction with SBA 7(a) loans. SBA 7(a) loans were originated with variable interest rates priced at spreads ranging from 1.75% to 2.75% over the prime lending rate.

RESULTS OF OPERATIONS

Comparison of Nine Months Ended September 30, 2001 and 2000

The following table summarizes Allied Capital s operating results for the nine months ended September 30, 2001 and 2000.

($ in thousands, except per share amounts)	For the Nine Months Ended September 30, 2001	2000	Change	Percent Change
Interest and Related Portfolio Income				
Interest and dividends	$173,722	$129,768	$43,954	34%
Premiums from loan dispositions	2,070	10,752	(8,682)	(81%)
Fees and other income	30,652	9,334	21,318	228%
Total interest and related portfolio income	206,444	149,854	56,590	38%
Expenses				
Interest	47,974	41,645	6,329	15%
Employee	22,269	19,506	2,763	14%
Administrative	10,166	10,711	(545)	(5%)

Total operating expenses	80,409	71,862	8,547	12%
Net operating income before net realized and unrealized gains	126,035	77,992	48,043	62%
Net Realized and Unrealized Gains				
Net realized gains	8,339	23,095	(14,756)	(64%)
Net unrealized gains	23,463	(267)	23,730	8,888%
Total net realized and unrealized gains	31,802	22,828	8,974	39%

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