ALLIED CAPITAL CORP
Form 497
May 16, 2008

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Registration Statement No. 333-150006

PROSPECTUS SUPPLEMENT
(To Prospectus dated May 14, 2008)

9,000,000 Shares
Common Stock

We are offering 9,000,000 shares of our common stock, par value $0.0001 per share. We will receive all of the net proceeds from the sale of our common stock.

Our common stock is traded on the New York Stock Exchange under the symbol ALD. The last reported sale price for our common stock on May 15, 2008, was $21.41 per share.

Please read this prospectus supplement, and the accompanying prospectus, before investing, and keep it for future reference. The prospectus supplement and the accompanying prospectus contain important information about us that a prospective investor should know before investing in our common stock. We file annual, quarterly and current reports, proxy statements and other information about us with the Securities and Exchange Commission. This information is available free of charge by contacting us at 1919 Pennsylvania Avenue, NW, Washington, DC, 20006, or by telephone at (202) 721-6100 or on our website at www.alliedcapital.com. The information on this website is not incorporated by reference into this prospectus supplement and the accompanying prospectus. The SEC also maintains a website at www.sec.gov that contains such information.

Before buying any of these shares of our common stock, you should review the information, including the risk of leverage, set forth under Risk Factors on page 10 of the accompanying prospectus.

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

	Per Share	Total
Public offering price	$20.45	$184,050,000
Underwriting discount	$ 0.92	$ 8,280,000
Proceeds, before expenses, to us(1)	$19.53	$175,770,000

(1) Expenses payable by us are estimated to be approximately $520,000.

If all the shares are not sold at the public offering price, the underwriters may change the offering price and may offer shares from time to time for sale in negotiated transactions or otherwise, at market prices prevailing at the time of sale, at prices related to such prevailing market prices or otherwise.

The underwriters may also purchase from us up to an additional 1,350,000 shares of our common stock at the public offering price less the underwriting discount, to cover over-allotments, if any, within 30 days of the date of this prospectus supplement.

The underwriters are offering the shares of our common stock as described in Underwriting. Delivery of the shares will be made on or about May 21, 2008.

Morgan Stanley **Citi** **Deutsche Bank Securities** **Merrill Lynch & Co.**

BB&T Capital Markets
a division of Scott & Stringfellow, Inc.

Davenport & Company LLC

Morgan Keegan & Company, Inc.

The date of this prospectus supplement is May 16, 2008

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

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Prospectus Supplement

ABOUT THIS PROSPECTUS

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

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

FEES AND EXPENSES

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

Shareholder Transaction Expenses	
Sales load (as a percentage of offering price)[(1)]	4.50%
Dividend reinvestment plan fees[(2)]	None
Annual Expenses (as a percentage of consolidated net assets attributable to common stock)[(3)]	
Expenses[(4)]	6.08%
Interest payments on borrowed funds[(5)]	5.68%
Acquired fund fees and expenses[(6)]	%
Total annual expenses[(7)(8)]	11.76%

Example

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

	1 Year	3 Years	5 Years	10 Years
You would pay the following expenses on a $1,000 investment, assuming a 5.0% annual return	$159	$381	$597	$1,107

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.

(1) Represents the underwriting discounts or commissions with respect to the shares sold by us in this offering.

(2) The expenses of our dividend reinvestment plan are included in 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 in the accompanying prospectus.

(3) Consolidated net assets attributable to common stock equals net assets (i.e., total consolidated assets less total consolidated liabilities), which at March 31, 2008, was $2.8 billion.

(4) Expenses represent our estimated operating expenses for the year ending December 31, 2008, including income tax expense (benefit) including excise tax, excluding interest on indebtedness. This percentage for the year ended December 31, 2007, was 6.80%. See Management s Discussion and Analysis of Financial Condition and Results of Operations in the accompanying prospectus.

(5) The Interest payments on borrowed funds represents our estimated interest expense for the year ending December 31, 2008 including interest related to usage under our revolving line of credit and new debt issuances during the remainder of 2008. We had outstanding borrowings of $2.2 billion at March 31, 2008. This percentage for the year ended December 31, 2007, was 4.77%. See Risk Factors in the accompanying prospectus.

(6) See our Consolidated Statement of Investments as of March 31, 2008, on pages F-76 through F-92 in the accompanying prospectus 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 6.55% 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.

USE OF PROCEEDS

We estimate that our net proceeds from the sale of the 9,000,000 shares of common stock we are offering will be approximately $175.3 million and approximately $201.6 million, if the underwriters over-allotment option is exercised in full, and after deducting the underwriting discount and estimated offering expenses payable by us.

We expect to use the net proceeds from this offering to reduce borrowings under our revolving line of credit, if any, to invest in debt or equity securities in primarily privately negotiated transactions, and for other general corporate purposes. Amounts repaid under our revolving line of credit will remain available for future borrowings. At May 14, 2008, the interest rate on our revolving line of credit was approximately 4.6% and there was approximately $345.3 million outstanding. This revolving line of credit expires on April 11, 2011.

UNDERWRITING

Subject to the terms and conditions set forth in our underwriting agreement, we are offering the shares of our common stock described in this prospectus supplement through the underwriters named below. Morgan Stanley & Co. Incorporated, Citigroup Global Markets Inc., Deutsche Bank Securities Inc. and Merrill Lynch, Pierce, Fenner & Smith Incorporated are acting as representatives. Each of the underwriters has severally agreed to purchase the number of shares of common stock listed next to its name in the following table:

Name	Number of Shares
Morgan Stanley & Co. Incorporated	2,025,000
Citigroup Global Markets Inc.	2,025,000
Deutsche Bank Securities Inc.	2,025,000
Merrill Lynch, Pierce, Fenner & Smith Incorporated	2,025,000
BB&T Capital Markets, a division of Scott & Stringfellow, Inc.	300,000
Davenport & Company LLC	300,000
Morgan Keegan & Company, Inc.	300,000
Total	9,000,000

The underwriting agreement provides that the obligations of the underwriters to purchase the shares of common stock offered hereby are subject to certain conditions precedent and that the underwriters will purchase all of the shares of common stock offered by this prospectus supplement, other than those covered by the over-allotment option described below, if any of these shares of our common stock are purchased by them.

The underwriters propose to offer the shares of common stock directly to the public at the public offering price set forth on the cover page of this prospectus supplement and to dealers at the public offering price less a concession not in excess of $0.532 per share. If all the shares are not sold at the public offering price, the underwriters may change the offering price and may offer shares from time to time for sale in negotiated transactions or otherwise, at market prices prevailing at the time of sale, at prices related to such prevailing market prices or otherwise.

We have granted to the underwriters an option to purchase up to 1,350,000 additional shares of common stock from us at the public offering price set forth on the cover page of this prospectus supplement less the underwriting discount. The underwriters may purchase additional shares only to cover over-allotments made in connection with this offering and only within 30 days after the date of this prospectus supplement. The underwriters will offer any additional shares that they purchase on the terms described above. If the underwriters exercise this option, each will be obligated, subject to conditions contained in the underwriting agreement, to purchase a number of additional shares approximately proportionate to that underwriter s initial amount reflected in the above table.

The underwriting discounts and commissions per share are equal to the public offering price per share of common stock less the amount paid by the underwriters to us per share of common stock. The underwriting discounts and commissions are 4.5% of the public offering price. The following table shows the underwriting discount per share that we are to pay to the underwriters in connection with this offering. These amounts are shown assuming either no exercise or full exercise by the underwriters of the underwriters over-allotment option:

		Total Fees	
	Fee Per Share	**Without Exercise of Over-Allotment Option**	**With Full Exercise of Over-Allotment Option**
Underwriting Discount	$0.92	$8,280,000	$9,522,000

We estimate that the total expenses of this offering, which will be paid by us, excluding the underwriting discount, will be approximately $520,000.

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

We and certain of our executive officers have agreed not to offer, sell, contract to sell or otherwise dispose of, or to engage in certain hedging and derivative transactions with respect to, our common stock for a period of 30 days after the date of this prospectus supplement, without first obtaining the written consent of Morgan Stanley & Co. Incorporated, Citigroup Global Markets Inc., Deutsche Bank Securities Inc. and Merrill Lynch, Pierce, Fenner & Smith Incorporated on behalf of the underwriters, except in limited circumstances, including our additional issuance of equity securities through privately negotiated transactions that may or may not involve an underwriter, whether or not registered with the SEC, aggregating not more than $150 million. This consent may be given at any time without public notice.

The underwriters do not intend to confirm sales to any account over which they exercise discretionary authority.

In connection with this offering, the underwriters may purchase and sell shares of our common stock in the open market. These transactions may include stabilizing transactions, short sales and purchases to cover positions created by short sales and stabilizing transactions.

Short sales involve the sale by the underwriters of a greater number of shares than they are required to purchase in this offering. Covered short sales are sales made in an amount not greater than the underwriters over-allotment option to purchase additional shares in this offering. The underwriters may close out any covered short position by either exercising their over-allotment option or purchasing shares in the open market. In determining the source of shares to close out the covered short position, the underwriters will consider, among other things, the price of shares available for purchase in the open market as compared to the price at which they may purchase shares through the over-allotment option.

Naked short sales are sales in excess of the over-allotment option. The underwriters must close out any naked short position by purchasing shares in the open market. A naked short position is more likely to be created if the underwriters are concerned there may be downward pressure on the price of shares in the open market prior to the completion of this offering.

Stabilizing transactions consist of various bids for or purchases of our common stock made by the underwriters in the open market prior to the completion of this offering.

The underwriters may impose a penalty bid. This occurs when a particular underwriter repays to the other underwriters a portion of the underwriting discount received by it because the representatives of the underwriters have repurchased shares sold by or for the account of that underwriter in stabilizing or short covering transactions.

Purchases to cover a short position and stabilizing transactions may have the effect of preventing or slowing a decline in the market price of our common stock. Additionally, these purchases may stabilize, maintain or otherwise affect the market price for our common stock. As a result, the price of our common stock may be higher than the price that might otherwise exist in the open market. These transactions may be effected on the New York Stock Exchange, in the over-the-counter market or otherwise.

The underwriters may make prospectuses available in electronic (PDF) format. A prospectus in electronic (PDF) format may be made available on a web site maintained by the underwriters, and the underwriters may distribute such prospectuses electronically. The underwriters intend to allocate a limited number of shares for sale to their online brokerage customers.

In the ordinary course of business, the underwriters or their affiliates have engaged and may in the future engage in various financing, commercial banking and investment banking services with, and provide financial advisory services to, us and our affiliates or controlled portfolio companies, for which they have received or may receive customary fees and expenses. Affiliates of Morgan Stanley & Co. Incorporated, Citigroup Global Markets Inc., Deutsche Bank Securities Inc., Merrill Lynch, Pierce, Fenner & Smith Incorporated and BB&T Capital Markets, a division of Scott & Stringfellow, Inc. are members of the lending syndicate for our unsecured revolving line of credit and will receive proceeds of this offering by reason of the repayment of amounts outstanding thereunder. Because more than 10% of the net proceeds of the offering may be received by members of FINRA participating in the offering or their affiliates, the offering is being conducted in accordance with FINRA Conduct Rule 2710(h).

The principal business address of Morgan Stanley & Co. Incorporated is 1585 Broadway, New York, NY 10036. The principal business address of Citigroup Global Markets Inc. is 388 Greenwich Street, New York, NY 10013. The principal business address of Deutsche Bank Securities Inc. is 60 Wall Street, 4th Floor, New York, NY 10005. The principal business address of Merrill Lynch, Pierce, Fenner & Smith Incorporated is 4 World Financial Center, 250 Vesey Street, New York, NY 10080.

LEGAL MATTERS

Certain legal matters with respect to the validity of the shares of common stock we are offering will be passed upon for us by Sutherland Asbill & Brennan LLP, Washington, D.C. Certain legal matters related to the offering will be passed upon for the underwriters by Fried, Frank, Harris, Shriver & Jacobson LLP, Washington D.C.

PROSPECTUS

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 directly to one or more purchasers, through agents designated from time to time by us, or to or through underwriters or dealers. The price and terms of any offering, including any applicable fee, commission or discount arrangement between us and any agents or underwriters or among our underwriters, or the basis upon which such amount may be calculated will be described in one or more supplements to this prospectus. See Plan of Distribution.

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 12, 2008, the last reported sale price on the New York Stock Exchange for the common stock was $21.26.

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.

May 14, 2008

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 an accompanying 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.

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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 78)*

We are a business development company in the private equity business and we are internally managed. Specifically, 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. Since then through March 31, 2008, we have invested more than $13 billion in 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, 2008, our private finance portfolio included investments in 124 companies that generate aggregate annual revenues of over $13 billion and employ more than 98,000 people.

We generally target companies in less cyclical industries with, among other things, management teams with meaningful equity ownership, high returns on invested capital, the ability to generate free cash flow, and well-capitalized balance sheets. 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 (an investment that combines both senior and subordinated financing, generally in a first lien position), 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 generally 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 earn income from management, consulting, diligence, structuring, or other fees. We may also enhance our total return with capital gains realized from investments in equity instruments or from equity features, such as nominal cost warrants.

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 also participated in commercial real estate finance over our history. Over the past few years, we have not actively participated in commercial real estate finance as we believed that the market for commercial real estate had become too aggressive and that investment opportunities were not priced appropriately. As a result, our commercial real estate finance portfolio totaled $115.8 million at value, or 2.3% of our total assets, at March 31, 2008. As the capital markets evolve and should commercial real estate investment opportunities improve, we may become more active investors in commercial real estate finance for our own portfolio or through a future managed fund.

In addition to managing our own assets, we manage certain funds that also invest in the debt and equity securities of primarily middle market companies in a variety of industries, which we refer to as Managed Funds. We may invest in the equity of these funds, along with other third parties, from which we may earn a current return and/or future incentive allocation. We may also manage the assets held by these funds, for which we may earn management or other fees for our services.

We are internally managed, led by an experienced management team with our senior officers and managing directors possessing, on average, 22 years of experience. At March 31, 2008, we had 186 employees, who are focused on transaction sourcing, origination and execution, portfolio monitoring, accounting, valuation and other operational and administrative activities. We are headquartered in Washington, DC, with offices in New York, NY, Chicago, IL, and Los Angeles, CA and have centralized investment approval and portfolio management processes.

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 102)*

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 in accordance with our valuation policy and the provisions of the 1940 Act and FASB Statement No. 157, *Fair Value Measurements* (SFAS 157). In the first quarter of 2008, we adopted SFAS 157. The adoption of SFAS 157 did not change our requirement to record our investments at fair value.

There is no single approach for determining fair value in good faith. As a result, determining fair value requires that judgment be applied to the specific facts and circumstances of each portfolio investment while employing a consistently applied valuation process for the types of investments we make. Unlike banks, we are not permitted to provide a general reserve for anticipated loan losses. Instead, we are required to specifically value each individual investment on a quarterly basis. 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. Additionally, changes in the market environment and other events that may occur over the life of our investments may cause the gains or losses ultimately realized on our investments to be different than the values determined at the measurement date.

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 153)*

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 directly to one or more purchasers, through agents designated from time to time by us, or to or through underwriters or dealers. The price and terms of any offering, including any applicable fee, commission or discount arrangement between us and any agents or underwriters or among our underwriters, or the basis upon which such amount may be calculated will be described in one or more supplements to this prospectus.

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 18)*

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 19)*

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.

Shares of business development companies may trade at a market price that is less than the value of the net assets attributable to those shares. Our common stock currently continues to trade in excess of net asset value. The possibility that our shares of common stock will trade at a discount from net asset value or at premiums that are unsustainable over the long term is separate and distinct from the risk that our net asset value will decrease. There can be no assurance, however, that our shares will continue to trade at a premium to our net asset value.

DIVIDEND REINVESTMENT PLAN *(Page 144)*

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.

Substantially all of our portfolio of investments, which are generally illiquid, are recorded at fair value, as determined in good faith by our Board of Directors. 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 repay our loans or engage in a liquidity event, such as a sale, recapitalization or initial public offering. 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.

Although funds managed by us may have a different primary investment objective than we do, the managed funds may invest in the same or similar asset classes that we target. There may be conflicts in the allocation of the investment opportunities between us and the managed funds. We have sold assets to certain managed funds and, as part of our investment strategy, we may offer to sell additional assets to managed funds or we may purchase assets from managed funds. While assets may be sold or purchased at prices that are consistent with those that could be obtained from third parties in the marketplace, there is an inherent conflict of interest in such transactions between us and funds we manage.

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

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

CERTAIN ANTI-TAKEOVER PROVISIONS *(Page 147)*

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)	
Expenses(4)	6.08%
Interest payments on borrowed funds(5)	5.68%
Acquired fund fees and expenses(6)	%
Total annual expenses(7)(8)	11.76%

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	$ 117	$ 345	$ 566	$ 1,089

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.

(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, 2008, was $2.8 billion.

(4) Expenses represent our estimated operating expenses for the year ending December 31, 2008, including income tax expense (benefit) including excise tax, excluding interest on indebtedness. This percentage for the year ended December 31, 2007, was 6.80%. 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, 2008, including interest related to usage under our revolving line of credit and new debt issuances during the remainder of 2008. We had outstanding borrowings of $2.2 billion at March 31, 2008. See Risk Factors. This percentage for the year ended December 31, 2007, was 4.77%.

(6) See our Consolidated Statement of Investments as of March 31, 2008, on pages F-76 through F-92 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 6.55% 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, 2007, 2006, 2005, 2004, and 2003, 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, 2008, are not necessarily indicative of the results that may be expected for the year ending December 31, 2008. **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, 2008	2007	At and for the Year Ended December 31, 2007	2006	2005	2004	2003
	(unaudited)						
Operating Data:							
Interest and related portfolio income:							
Interest and dividends	$ 134,660	$ 101,983	$ 417,576	$ 386,427	$ 317,153	$ 319,642	$ 290,719
Fees and other income	10,284	5,969	44,129	66,131	56,999	47,448	38,510
Total interest and related portfolio income	144,944	107,952	461,705	452,558	374,152	367,090	329,229
Expenses:							
Interest	37,560	30,288	132,080	100,600	77,352	75,650	77,233
Employee	22,652	21,928	89,155	92,902	78,300	53,739	36,945
Employee stock options(1)	4,195	3,661	35,233	15,599			
Administrative	9,019	13,224	50,580	39,005	69,713	34,686	22,387
Total operating expenses	73,426	69,101	307,048	248,106	225,365	164,075	136,565
Net investment income before income taxes	71,518	38,851	154,657	204,452	148,787	203,015	192,664
Income tax expense (benefit), including excise tax	1,969	(649)	13,624	15,221	11,561	2,057	(2,466)
Net investment income	69,549	39,500	141,033	189,231	137,226	200,958	195,130
Net realized and unrealized gains (losses):							
Net realized gains	3,143	27,666	268,513	533,301	273,496	117,240	75,347
	(113,404)	65,920	(256,243)	(477,409)	462,092	(68,712)	(78,466)

Net change in unrealized appreciation or depreciation							
Total net gains (losses)	(110,261)	93,586	12,270	55,892	735,588	48,528	(3,119)
Net increase (decrease) in net assets resulting from operations	$ (40,712)	$ 133,086	$ 153,303	$ 245,123	$ 872,814	$ 249,486	$ 192,011
Per Share:							
Diluted earnings (loss) per common share	$ (0.25)	$ 0.87	$ 0.99	$ 1.68	$ 6.36	$ 1.88	$ 1.62
Net investment income plus net realized gains per share(2)	$ 0.45	$ 0.44	$ 2.65	$ 4.96	$ 2.99	$ 2.40	$ 2.28
Dividends per common share(2)	$ 0.65	$ 0.63	$ 2.64	$ 2.47	$ 2.33	$ 2.30	$ 2.28
Weighted average common shares outstanding diluted	161,507	152,827	154,687	145,599	137,274	132,458	118,351

(in thousands, except per share data)	At and for the Three Months Ended March 31, 2008 (unaudited)	At and for the Year Ended December 31, 2007	2006	2005	2004	2003
Balance Sheet Data:						
Portfolio at value	$ 4,635,633	$ 4,780,521	$ 4,496,084	$ 3,606,355	$ 3,013,411	$ 2,584,599
Total assets	5,082,242	5,214,576	4,887,505	4,025,880	3,260,998	3,019,870
Total debt outstanding(3)	2,191,563	2,289,470	1,899,144	1,284,790	1,176,568	954,200
Undistributed (distributions in excess of) earnings	500,464	535,853	502,163	112,252	12,084	(13,401)
Shareholders equity	2,828,418	2,771,847	2,841,244	2,620,546	1,979,778	1,914,577
Shareholders equity per common share (net asset value)(4)	$ 16.99	$ 17.54	$ 19.12	$ 19.17	$ 14.87	$ 14.94
Common shares outstanding at end of period	166,472	158,002	148,575	136,697	133,099	128,118
Asset coverage ratio(5)	229%	221%	250%	309%	280%	322%
Debt to equity ratio	0.77	0.83	0.67	0.49	0.59	0.50
Other Data:						
Investments funded	$ 275,130	$ 1,845,973	$ 2,437,828	$ 1,675,773	$ 1,524,523	$ 931,450
Principal collections related to investment repayments or sales	264,777	1,211,550	1,055,347	1,503,388	909,189	788,328
Realized gains	32,740	400,510	557,470	343,061	267,702	94,305
Realized losses	(29,597)	(131,997)	(24,169)	(69,565)	(150,462)	(18,958)

(in thousands, except per share data)	2008 Qtr 1	2007 Qtr 4	Qtr 3	Qtr 2	Qtr 1	2006 Qtr 4	Qtr 3	Qtr 2	Qtr 1
Quarterly Data (unaudited):									
Total interest and related portfolio income	$144,944	$117,709	$118,368	$117,676	$107,952	$117,708	$113,383	$110,456	$111,011
Net investment income	69,549	58,040	18,318	25,175	39,500	49,078	48,658	50,195	41,300
Net increase (decrease) in net assets resulting from operations	(40,712)	27,527	(96,468)	89,158	133,086	33,921	77,886	33,729	99,587
	$(0.25)	$0.18	$(0.63)	$0.57	$0.87	$0.23	$0.53	$0.24	$0.70

Diluted earnings (loss) per common share									
Dividends declared per common share [6]	0.65	0.72	0.65	0.64	0.63	0.67	0.61	0.60	0.59
Net asset value per common share[4]	16.99	17.54	17.90	19.59	19.58	19.12	19.38	19.17	19.50

(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. 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 2007 included the regular quarterly dividend of $0.65 per common share and an extra dividend of $0.07 per common share. 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.

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 the collateral for a loan, if any.

Substantially all of our portfolio investments, which are generally illiquid, are recorded at fair value as determined in good faith by our Board of Directors and, as a result, there is uncertainty regarding the value of our portfolio investments. At March 31, 2008, portfolio investments recorded at fair value were 91% of our total assets. Pursuant to the requirements of the 1940 Act, we value substantially all of our investments at fair value as determined in good faith by our Board of Directors on a quarterly basis. Since there is typically no market quotation in an active market for the investments in our portfolio, our Board of Directors determines in good faith the fair value of these investments pursuant to a valuation policy and a consistently applied valuation process.

There is no single approach for determining fair value in good faith. As a result, determining fair value requires that judgment be applied to the specific facts and circumstances of each portfolio investment while employing a consistently applied valuation process for the types of investments we make. In determining fair value in good faith, we generally obtain financial and other information from portfolio companies, which may represent unaudited, projected or 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. We will record unrealized depreciation on investments when we determine that the fair value of a security is less than its cost basis, and unrealized appreciation when we determine that the fair value of a security is greater than its cost basis. Without a market quotation in an active market and because of the inherent uncertainty of valuation, the fair value of our investments determined in good faith by the Board of Directors may differ significantly from the values that would have been used had a ready market existed for the investments, and the differences could be material. Our net asset value could be affected if our determination of the fair value of our investments is materially different than the value that we ultimately realize.

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

Beginning in the quarter ended March 31, 2008, we adopted the provisions of Statement No. 157, *Fair Value Measurements*, on a prospective basis. Adoption of this statement did not have a material effect on our consolidated financial statements for the first quarter of 2008. However, the impact on our consolidated financial statements in the periods subsequent to the period of adoption cannot be determined at this time as it will be influenced by the estimates of fair value for those periods, the number and amount of investments we originate, acquire or exit and the effect of any additional guidance or any changes in the interpretation of this statement. See Note 2, Summary of Significant Accounting Policies from our Notes to the Consolidated Financial Statements.

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

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

Our financial results could be negatively affected if a significant portfolio 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, 2008, our investment in Ciena Capital LLC (Ciena) totaled $327.8 million at cost and $29.3 million at value, after the effect of unrealized depreciation of $298.5 million. In addition, we have an unconditional guarantee of 100% of the total obligations under Ciena s revolving credit facility that totaled $384.8 million at March 31, 2008. The guarantee can be called by the lenders in event of default. In addition, we have issued performance guarantees in connection with two non-recourse warehouse facilities. Ciena focuses on loan products that provide financing to commercial real estate owners and operators. Ciena relies on the asset-backed securitization market to finance its loan origination activity. That financing source continues to be unreliable in the current capital markets, and as a result, Ciena has substantially curtailed loan origination activity. Ciena continues to reposition its business; however, there is an inherent risk in repositioning the business and we continue to work with Ciena on restructuring. Our financial results could be negatively affected if Ciena defaults on its revolving line of credit or is not able to reposition its business.

Ciena is a participant in the SBA s 7(a) Guaranteed Loan Program and its wholly-owned subsidiary 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 ongoing investigations of allegedly fraudulently obtained SBA-guaranteed loans issued by Ciena. As an SBA lender, Ciena is also subject to other SBA and OIG audits, investigations, and reviews. In addition, the Office of the Inspector General of the U.S. Department of Agriculture is conducting an investigation of Ciena s lending practices under the Business and Industry Loan program. The OIG and the U.S. Department of Justice are also conducting a civil investigation of Ciena s lending practices in various jurisdictions. These investigations, audits, and reviews are ongoing. These investigations, audits, and reviews have had and may continue to have a material adverse impact on Ciena and, as a result, could negatively affect our financial results. See Management s Discussion and Analysis of Financial Condition and Results of Operations Private Finance, Ciena Capital LLC, and Valuation of Ciena Capital 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, 2008, we had $2.2 billion of outstanding indebtedness bearing a weighted average annual interest cost of 6.2% and a debt to equity ratio of 0.77 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

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payments on indebtedness, we must achieve annual returns on our assets of at least 2.7% as of March 31, 2008, 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) $5,082.2 million in total assets, (ii) an average cost of funds of 6.2%, (iii) $2,191.6 million in debt outstanding and (iv) $2,828.4 million of shareholders equity.

	Assumed Return on Our Portfolio (net of expenses)						
	-20%	**-10%**	**-5%**	**0%**	**5%**	**10%**	**20%**
Corresponding return to shareholder	-40.74%	-22.77%	-13.79%	-4.80%	4.18%	13.16%	31.13%

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, 2008, our asset coverage for senior indebtedness was 229%.

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, 2008, 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 ordinary 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 (i) 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 and (ii) may only issue new equity capital at a price, net of discounts and commissions, above our net asset value unless we have received shareholder approval. 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.

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

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

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

Our 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, asset managers, and real estate investment trusts may significantly affect our business. There are proposals being considered by the current administration to change the regulation of financial institutions that may affect, possibly adversely, investment managers or investment funds. Any change in the 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. 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 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 continue or the negative thereof or ot 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, including economic downturns or recessions;
- risks associated with possible disruption in our operations due to terrorism;
- future changes in laws or regulations or changes in accounting principles; and
- other risks and uncertainties as may be detailed from time to time in our public announcements and SEC filings.

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 and the Nasdaq Global Select Market 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 12, 2008, the last reported closing sale price of our common stock was $21.26 per share.

	NAV(1)	Closing Sales Price High	Closing Sales Price Low	Premium of High Sales Price to NAV(2)	Premium of Low Sales Price to NAV(2)	Declared Dividends
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	$ 19.59	$ 32.96	$ 28.90	168%	148%	$ 0.64
Third Quarter	$ 17.90	$ 32.87	$ 27.10	184%	151%	$ 0.65
Fourth Quarter	$ 17.54	$ 30.90	$ 21.15	176%	121%	$ 0.65
Extra Dividend						$ 0.07
Year ended December 31, 2008						
First Quarter	$ 16.99	$ 23.26	$ 18.38	137%	108%	$ 0.65
Second Quarter (through May 12, 2008)	*	$ 21.26	$ 18.80	*	*	$ 0.65

(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.

Shares of business development companies may trade at a market price that is less than the value of the net assets attributable to those shares. Our common stock currently continues to trade in excess of net asset value. The possibility that our shares of common stock will trade at a discount from net asset value or at premiums that are unsustainable over the long term is separate and distinct from the risk that our net asset value will decrease. There can be no assurance, however, that our shares will continue to trade at a premium to our net asset value.

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

We 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.

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, 2008 and 2007, and at December 31, 2007, 2006, and 2005, was as follows:

	March 31,		December 31,		
	2008	2007	2007	2006	2005
Private finance	98%	97%	97%	97%	96%
Commercial real estate finance	2%	3%	3%	3%	4%

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 primarily results from the stated interest rate earned on a loan or debt security and the amortization of loan origination fees and discounts. The level of interest income is directly related to the balance of the interest-bearing investment portfolio outstanding during the 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 and managed funds. 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 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, 2008 and 2007, and at and for the years ended December 31, 2007, 2006, and 2005, were as follows:

	At and for the Three Months Ended March 31,		At and for the Years Ended December 31,		
	2008	**2007**	**2007**	**2006**	**2005**
($ in millions)					
Portfolio at value	$ 4,635.6	$ 4,498.8	$ 4,780.5	$ 4,496.1	$ 3,606.4
Investments funded[(1)]	$ 275.1	$ 170.2	$ 1,846.0	$ 2,437.8	$ 1,675.8
Payment-in-kind or reinvested interest and dividends, net of collection	$ 13.4	$ 8.1	$ 12.0	$ 7.3	$ 25.7
Principal collections related to investment repayments or sales[(2)]	$ 264.8	$ 235.5	$ 1,211.6	$ 1,055.3	$ 1,503.4
Yield on interest-bearing investments[(3)]	12.3%	11.6%	12.1%	11.9%	12.8%

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

(2) Principal collections related to investment repayments or sales for the three months ended March 31, 2008, and for the year ended December 31, 2007, included collections of $30.0 million and $224.2 million, respectively, related to the sale of loans to the Allied Capital Senior Debt Fund, L.P. See discussion below.

(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, plus the effective interest yield on the preferred shares/income notes of CLOs, plus the annual stated interest (LIBOR plus 7.5%) on the subordinated certificates in the Unitranche Fund LLC divided by (b) total interest-bearing investments at value. The weighted average yield is computed as of the balance sheet date.

Private Finance

The private finance portfolio at value, investment activity, and the yield on loans and debt securities at and for the three months ended March 31, 2008 and 2007, and at and for the years ended December 31, 2007, 2006, and 2005, were as follows:

	At and for Three Months Ended March 31,				At and for the Years Ended December 31,					
	2008		2007		2007		2006		2005	
($ in millions)	Value	Yield(1)	Value	Yield(1)	Value	Yield(1)	Value	Yield(1)	Value	Yield(1)
Portfolio at value:										
Loans and debt securities:										
Senior loans	$ 325.7	7.0%	$ 365,0	8.4%	$ 344.3	7.7%	$ 405.2	8.4%	$ 239.8	9.5%
Unitranche debt	655.7	11.8%	780.2	11.4%	653.9	11.5%	799.2	11.2%	294.2	11.4%
Subordinated debt	2,430.4	13.0%	1,946.1	12.5%	2,416.4	12.8%	1,980.8	12.9%	1,560.9	13.8%
Total loans and debt securities	3,411.8	12.2%	3,091.3	11.7%	3,414.6	12.1%	3,185.2	11.9%	2,094.9	13.0%
Equity securities:										
Preferred shares/income notes of CLOs(2)	197.4	15.8%	96.1	13.5%	203.0	14.6%	97.2	15.5%	72.3	13.7%
Subordinated certificates in Unitranche Fund LLC(2)	31.5	12.4%			0.7	12.4%				
Other equity securities	879.1		1,188.9		1,041.0		1,095.5		1,312.1	
Total equity securities	1,108.0		1,285.0		1,244.7		1,192.7		1,384.4	
Total portfolio	$ 4,519.8		$ 4,376.3		$ 4,659.3		$ 4,377.9		$ 3,479.3	

Investments funded(3)	$ 274.6	$ 170.2	$ $1,828.0	$ 2,423.4	$ 1,462.3
Payment-in-kind interest and dividends, net of collections	$ 13.2	$ 5.3	$ 12.7	$ 3.4	$ 25.7
Principal collections related to investment repayments or sales(4)	$ 256.4	$ 235.1	$ 1,188.2	$ 1,015.4	$ 703.9

(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 on the preferred shares/income notes of CLOs is calculated as the (a) effective interest yield on the preferred shares/income notes of CLOs, divided by (b) preferred shares/income notes of CLOs at value. The weighted average yield on the subordinated certificates in the Unitranche Fund LLC is computed as the (a) annual stated interest (LIBOR plus 7.5%) divided by (b) total investment at value. The weighted average yields are computed as of the balance sheet date.

(2) Investments in the preferred shares/income notes of CLOs and subordinated certificates in the Unitranche Fund LLC earn a current return that is included in interest income in the consolidated statement of operations.

(3) Investments funded for the year ended December 31, 2006, included debt investments in certain portfolio companies received in conjunction with the sale of such companies. See Private Finance - Investments Funded below.

(4) Includes collections from the sale or repayment of senior loans totaling $48.6 million, $94.7 million, $393.4 million, $322.7 million, and $301.8 million for the three months ended March 31, 2008 and 2007, and for the years ended December 31, 2007, 2006, and 2005, respectively.

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 (an investment that combines both senior and subordinated financing, generally in a first lien position), or subordinated debt (with or without equity features). The junior debt that we 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. In addition, we may invest in funds that are managed or co-managed by us that are complementary to our business of investing in middle market companies, such as the Allied Capital Senior Debt Fund L.P. and the Unitranche Fund LLC. Investments in funds may provide current interest and related portfolio income, including management fees.

During the first six months of 2007, we found it difficult to find investments with attractive prices and structures. As a result, new investment activity was lower than in prior quarters. During the second half of 2007 and into the first quarter of 2008, our investment pace increased as pricing and structures improved. In the first quarter of 2008, we invested 274.6 million in private finance as compared to $170.2 million in the first quarter of 2007.

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.

Investments Funded. Investments funded and the weighted average yield on loans and debt securities funded for the three months ended March 31, 2008 and 2007, and for the years ended December 31, 2007, 2006, and 2005, consisted of the following:

	For the Three Months Ended March 31, 2008					
	Debt Investments		Buyout Investments		Total	
($ in millions)	Amount	Weighted Average Yield(1)	Amount	Weighted Average Yield(1)	Amount	Weighted Average Yield(1)
Loans and debt securities:						
Senior loans	$ 26.8	7.4%	$ 10.4	6.7%	$ 37.2	7.2%
Unitranche debt(2)	4.5	10.3%	0.5	6.6%	5.0	9.9%
Subordinated debt	129.9(4)	12.0%	31.3	14.2%	161.2	12.4%
Total loans and debt securities	161.2	11.2%	42.2	12.3%	203.4	11.4%
Preferred shares/income notes of CLOs (5)	3.0	27.6%			3.0	27.6%
Subordinated certificates in Unitranche Fund LLC	30.7	12.4%			30.7	12.4%
Equity	13.6		23.9		37.5	
Total	$ 208.5		$ 66.1		$ 274.6	

	For the Three Months Ended March 31, 2007					
	Debt Investments		Buyout Investments		Total	
($ in millions)	Amount	Weighted Average Yield(1)	Amount	Weighted Average Yield(1)	Amount	Weighted Average Yield(1)
Loans and debt securities:						
Senior loans	$ 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	

	2007 Investments Funded					
	Debt Investments		Buyout Investments		Total	
($ in millions)	Amount	Weighted Average Yield(1)	Amount	Weighted Average Yield(1)	Amount	Weighted Average Yield(1)
Loans and debt securities:						
Senior loans	$ 249.0	9.2%	$ 63.1	8.8%	$ 312.1	9.1%
Unitranche debt(2)	109.1	10.8%	74.9	13.0%	184.0	11.7%
Subordinated debt	719.4(4)	12.8%	197.6	12.1%	917.0	12.6%
Total loans and debt securities	1,077.5	11.7%	335.6	11.7%	1,413.1	11.7%
Preferred shares/income notes of CLOs (5)	116.2	16.4%			116.2	16.4%
Subordinated certificates in Unitranche Fund LLC	0.7	12.4%			0.7	12.4%
Equity	152.0(6)		146.0		298.0	
Total	$ 1,346.4		$ 481.6		$ 1,828.0	

($ in millions)	2006 Investments Funded					
	Debt Investments		Buyout Investments		Total	
	Amount	Weighted Average Yield(1)	Amount	Weighted Average Yield(1)	Amount	Weighted Average Yield(1)
Loans and debt securities:						
Senior loans	$ 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%
Preferred shares/income notes of CLOs (5)	26.1	14.8%			26.1	14.8%
Equity	65.3		294.1		359.4	
Total	$ 1,319.2		$ 1,104.2		$ 2,423.4	

($ in millions)	2005 Investments Funded					
	Debt Investments		Buyout Investments		Total	
	Amount	Weighted Average Yield(1)	Amount	Weighted Average Yield(1)	Amount	Weighted Average Yield(1)
Loans and debt securities:						
Senior loans	$ 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%
Preferred shares/income notes of CLOs(5)	47.9	14.2%			47.9	14.2%
Equity	34.6		165.5		200.1	
Total	$ 715.7		$ 746.6		$ 1,462.3	

(1) The weighted average yield on interest-bearing investments is computed as the (a) annual stated interest on accruing interest-bearing investments, divided by (b) total interest-bearing investments funded. The weighted average yield on the preferred shares/income notes of CLOs is calculated as the (a) effective interest yield on the preferred shares/income notes of CLOs, divided by (b) preferred shares/income notes of CLOs funded. The weighted average yield on the subordinated certificates in the Unitranche Fund LLC is computed as the (a) annual stated interest (LIBOR plus 7.5%) divided by (b) total investment at value. The weighted average yield is calculated using yields as of the date an investment is funded.

(2) Unitranche debt is an investment that combines both senior and subordinated financing, generally in a first lien position. The yield on a unitranche investment reflects the blended yield of senior and subordinated debt.

(3) 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.

(4) Subordinated debt investments for the three months ended March 31, 2008, and the years ended December 31, 2007 and 2005, included $2.0 million, $45.3 million and $45.5 million, respectively, in investments in the bonds of collateralized loan obligations (CLOs) and one collateralized debt obligations (CDO). Certain of these CLOs and the CDO are managed by Callidus Capital Corporation (Callidus), a portfolio company controlled by us. These CLOs and the CDO primarily invest in senior corporate loans.

(5) CLO equity investments included preferred shares/income notes of CLOs that primarily invest in senior corporate loans. Certain of these CLOs are managed by Callidus.

(6) Equity investments for the year ended December 31, 2007, included $31.8 million invested in the Allied Capital Senior Debt Fund, L.P. See Managed Funds below.

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

We may underwrite or arrange senior loans related to our portfolio investments or for other companies that are not in our portfolio. When we underwrite or arrange senior loans, we may earn a fee for such activities. Senior loans underwritten or arranged by us may be funded by us at closing. When these senior loans are closed, we may fund all or a portion of the underwritten commitment pending sale of the loan to other investors, which may include loan sales to Callidus Capital Corporation (Callidus), a portfolio company controlled by us, or funds managed by Callidus or by us, including the Allied Capital Senior Debt Fund, L.P. (discussed below). After completion of loan sales, we may retain a position in these senior loans. We generally earn a fee on the senior loans we underwrite or arrange whether or not we fund the underwritten commitment. In addition, we may fund most or all of the debt and equity capital upon the closing of certain buyout transactions, which may include investments in lower-yielding senior debt. Subsequent to the closing, the portfolio company may refinance all or a portion of the lower-yielding senior debt, which would reduce our investment. Principal collections include repayments of senior debt funded by us that was subsequently sold by us or refinanced or repaid by the portfolio companies.

We are currently focused on selling or encouraging the recapitalization or refinancing of some of our lower yielding debt investments. We may sell loans or debt securities to Managed Funds or portfolio companies may refinance their debt through a Managed Fund.

Yield. The weighted average yield on the private finance loans and debt securities was 12.2% at March 31, 2008, as compared to 11.7%, 12.1%, 11.9% and 13.0% at March 31, 2007, December 31, 2007, 2006 and 2005, 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.

The yield on the private finance portfolio declined in 2006 and 2007 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. In addition, during the fourth quarter of 2006, the guaranteed dividend yield on our investment in Ciena Capital LLC s 25% Class A equity interests was placed on non-accrual status. The Class A equity interests are included in our loans and debt securities. See Ciena Capital LLC below.

Outstanding Investment Commitments. At March 31, 2008, 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	$ 8.6	$ 12.0	$ 98.5	$ 119.1[2]
Unitranche debt	3.0		44.6	47.6
Subordinated debt	23.0	4.3		27.3
Total loans and debt securities	34.6	16.3	143.1	194.0
Unitranche Fund[3]	493.5			493.5
Equity securities	91.7	9.8	56.3	157.8[4]
Total	$ 619.8	$ 26.1	$ 199.4	$ 845.3

(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 loan obligations (CLOs), collateralized debt obligations (CDOs), 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	$ 1.6	$ 2.4
Subordinated debt to support warehouse facilities & warehousing activities[*]	18.0	4.0	14.0
Total	$ 22.0	$ 5.6	$ 16.4

(*) Callidus has a synthetic credit facility with a third party for up to approximately $55 million. We have agreed to designate our subordinated debt commitment for Callidus to draw upon to provide first loss capital as needed to support this facility.

(2) Includes $113.2 million in the form of revolving senior debt facilities to 33 companies.

(3) Represents our commitment to the Unitranche Fund LLC (see discussion below), which we estimate will be funded over a two to three year period as investments are made by the Unitranche Fund.

(4)

Includes $66.1 million to 13 private equity and venture capital funds, including $3.9 million in co-investment commitments to one private equity fund.

In addition to these outstanding investment commitments at March 31, 2008, 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. See Financial Condition, Liquidity and Capital Resources below.

Investments in Collateralized Loan Obligations and Collateralized Debt Obligations (CLO/CDO Assets). At both March 31, 2008, and December 31, 2007, we had investments in ten CLO issuances and one CDO bond, which represented 5.7% and 5.6% of our total assets, respectively, and five CLO issuances and one CDO bond, which represented 2.9% of our total assets, at December 31, 2006. At March 31, 2008, and at December 31, 2007 and 2006, our CLO/CDO Assets were as follows:

	2008			**2007**			**2006**		
($ in millions)	**Cost**	**Value**	**Yield[(1)]**	**Cost**	**Value**	**Yield[(1)]**	**Cost**	**Value**	**Yield[(1)]**
CLO/CDO bonds	$ 92.7	$ 92.1	12.7%	$ 90.7	$ 89.9	13.3%	$ 45.4	$ 45.6	12.8%
Preferred shares/income notes of CLOs	224.1	197.4	15.8%	218.3	203.0	14.6%	101.1	97.2	15.5%
Total	$ 316.8	$ 289.5		$ 309.0	$ 292.9		$ 146.5	$ 142.8	

(1) The weighted average yield is calculated as the (a) annual stated interest or the effective interest yield on the accruing bonds or the effective interest yield on the preferred shares/income notes, divided by (b) CLO and CDO assets at value.

The market yield used in the valuation of the CLO and CDO assets may be different than the interest yields shown above. See discussion below.

The CLO and CDO issuances in which we have invested are primarily invested in senior corporate loans. See also Note 3, Portfolio from our Notes to the Consolidated Financial Statements.

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

The CLOs and CDO in which we invest are invested primarily in first lien loans to corporate borrowers. We are not an investor in CLOs and CDO that hold subprime residential real estate loans. The CLO/CDO Assets in which we have invested are junior in priority for payment of interest and principal to the more senior notes issued by the CLOs and CDO. Cash flow from the underlying collateral assets in the CLOs and CDO is generally allocated first to the senior bonds in order of priority, then any remaining cash flow is generally distributed to the preferred shareholders and income note holders. To the extent there are defaults and unrecoverable losses on the underlying collateral assets that result in reduced cash flows, the preferred shares/income notes will bear this loss first and then the subordinated bonds would bear any loss after the preferred shares/income notes. At March 31, 2008, and December 31, 2007 and 2006, the face value of the CLO/CDO Assets held by us was subordinate to as much as 94%, 94% and 92%, respectively, of the face value of the securities outstanding in these CLOs and CDO.

At March 31, 2008, and December 31, 2007 and 2006, the underlying collateral assets of these CLO and CDO issuances, consisting primarily of senior corporate loans, were issued by 636 issuers, 671 issuers and 465 issuers, respectively, and had balances as follows:

($ in millions)	2008	2007	2006
Bonds	$ 286.1	$ 288.5	$ 245.4
Syndicated loans	4,206.5	4,122.7	1,769.9
Cash[1]	101.4	104.4	59.5
Total underlying collateral assets[2]	$ 4,594.0	$ 4,515.6	$ 2,074.8

(1) Includes undrawn liability amounts.

(2) At March 31, 2008, and December 31, 2007 and 2006, the total face value of defaulted obligations was $42.3 million, $18.4 million and $9.6 million, respectively, or approximately 0.9%, 0.4% and 0.5%, respectively, of the total underlying collateral assets.

Since the third quarter of 2007, the debt capital markets have been volatile and market yields for CLO securities have increased. We believe the market yields for our investments in CLO preferred shares/income notes have increased, and as a result, the fair value of certain of our investments in these assets has decreased. At March 31, 2008, the market yields used to value our preferred shares/income notes were 22% to 23%, with the exception of the income notes in one CLO with a cost and value of $23.1 million where we used a market yield of 18% due to the characteristics of the issuance. At December 31, 2007, the market yields used to value our preferred shares/income notes were 20% to 21%, with the exception of the income notes in one CLO with a cost and value of $18.7 million where we used a market yield of 15.9% and one CLO with a cost and value of $22.1 million where we used a market yield of 18% due to the characteristics of these issuances. Net change in unrealized appreciation or depreciation for the three months ended March 31, 2008, and for the year ended December 31, 2007,

included a net decrease of $11.2 million and $12.4 million, respectively, related to our investments in CLO/CDO Assets. We received valuation assistance for our investments in the CLO/CDO Assets in each quarter of 2007 and in the first quarter of 2008. See Results of Operations Valuation Methodology Private Finance below for further discussion of the third-party valuation assistance we received.

Ciena Capital LLC. Ciena Capital LLC (f/k/a Business Loan Express, LLC) (Ciena) focuses on loan products that provide financing to commercial real estate owners and operators. Ciena is also a participant in the SBA s 7(a) Guaranteed Loan Program and its wholly-owned subsidiary is licensed by the SBA as a Small Business Lending Company (SBLC). Ciena is headquartered in New York, NY and maintains offices in other U.S. locations. We invested in Ciena in 2000.

At March 31, 2008, our investment in Ciena totaled $327.8 million at cost and $29.3 million at value, after the effect or unrealized depreciation of $298.5 million. See Results of Operations, Valuation of Ciena Capital LLC for a discussion of the determination of the value of Ciena at March 31, 2008. At December 31, 2007, our investment in Ciena totaled $327.8 million at cost and $68.6 million at value, after the effect of unrealized depreciation of $259.2 million. In 2007, we increased our investment in Ciena by $32.4 million. We acquired $29.2 million in additional Class A equity interests to fund payments to the SBA discussed below and to provide additional capital to Ciena. In addition, we purchased $3.2 million in Class A equity interests from Ciena s former Chief Executive Officer. At December 31, 2006, our investment in Ciena totaled $295.3 million at cost and $210.7 million at value, after the effect of unrealized depreciation of $84.6 million.

Net change in unrealized appreciation or depreciation included a net decrease on our investment in Ciena of $39.3 million, $174.5 million and $142.3 million for the three months ended March 31, 2008, and for the years ended December 31, 2007 and 2006, respectively, and a net increase of $2.9 million for the year ended December 31, 2005. See Results of Operations, Valuation of Ciena Capital LLC below.

Total interest and related portfolio income earned from our investment in Ciena for the three months ended March 31, 2008, and 2007, and for the years ended December 31, 2007, 2006, and 2005, was as follows:

($ in millions)	Three Months Ended March 31, 2008	Three Months Ended March 31, 2007	Year Ended 2007	Year Ended 2006	Year Ended 2005
Interest income on subordinated debt and Class A equity interests[1]	$	$	$	$ 11.9	$ 14.3
Dividend income on Class B equity interests[1]					14.0
Fees and other income		1.4	5.4	7.8	9.2
Total interest and related portfolio income	$	$ 1.4	$ 5.4	$ 19.7	$ 37.5

(1) Interest and dividend income from Ciena for the years ended December 31, 2006 and 2005, included interest and dividend income of $5.7 million and $8.9 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 Ciena s 25% Class A equity interests on non-accrual status. As a result, there was no interest income from our investment in Ciena for the three months ended March 31, 2008 and 2007, and for the year ended December 31, 2007, and interest income for 2006 was lower as compared to 2005. In consideration for providing a guaranty on Ciena s revolving credit facility and standby letters of credit (discussed below), we earned fees of $1.4 million, $5.4 million, $6.1 million, and $6.3 million for the three months ended March 31, 2007 and for the years ended December 31, 2007, 2006, and 2005, respectively, which were included in fees and other income. Ciena has not yet paid the $5.4 million in such fees earned by us in 2007. At both March 31, 2008 and at December 31, 2007, such fees were included as a receivable in other assets. We considered this outstanding receivable in our valuation of Ciena at March 31, 2008, and at December 31, 2007. We did not accrue the fees earned from Ciena for providing the guaranty and standby letters of credit for the three months ended March 31, 2008. The remaining fees and other income in 2006 and 2005 relate to management fees from Ciena. We did not charge Ciena management fees in the first quarter of 2008, in 2007 or in the fourth quarter of 2006.

We guarantee Ciena s revolving credit facility that matures in March 2009. On January 30, 2008, Ciena completed an amendment of the terms of its revolving credit facility. The amendment reduced the commitments from the lenders under the facility from $500 million to $450 million at the effective date of the amendment, with further periodic reductions in total commitments to $325 million by December 31, 2008. In addition, certain financial and other covenants were amended. In connection with this amendment, we increased our unconditional guarantee from 60% to 100% of the total obligations under this facility (consisting of principal, letters of credit issued under the facility, accrued interest, and other fees) and replaced $42.5 million in letters of credit issued under the Ciena credit facility with new letters of credit under our revolving line of credit. The guaranty of the Ciena revolving credit facility can be called by the lenders in the event of a default, which includes the occurrence of any event of default under our revolving credit facility, subject to grace periods in certain cases. The amendment also prohibits cash payments from Ciena to us for interest, guarantee fees, management fees, and dividends. At March 31, 2008, the principal amount outstanding on Ciena s revolving credit facility was $335.0 million and letters of credit issued under the facility were $46.9 million. The total obligation guaranteed by us at March 31, 2008, was $384.8 million. At March 31, 2008, we had provided standby letters of credit totaling $59.5 million in connection with term securitizations completed by Ciena. At December 31, 2007, the total obligation guaranteed by us was $258.7 million, and we had provided four standby letters of credit totaling $18.0 million in connection with four term securitization transactions completed by Ciena.

Ciena relies on the asset-backed securitization market to finance its loan origination activity. That financing source continues to be unreliable in the current capital markets, and as a result, Ciena has substantially curtailed loan origination activity, including loan originations under the SBA s 7(a) Guaranteed Loan Program. Ciena continues to reposition its business. However, there is an inherent risk in this repositioning and we continue to work with Ciena on restructuring. Ciena maintains two non-recourse securitization warehouse facilities, and there is no assurance that Ciena will be able to refinance these facilities in the loan securitization market. We have issued performance guaranties whereby we have agreed to indemnify the warehouse providers for any damages, losses, liabilities and related costs and expenses that they may incur as a result of Ciena s failure to perform any of its obligations as loan originator, loan seller or loan servicer under the warehouse securitizations.

The Office of the Inspector General of the SBA (OIG) and the United States Secret Service are conducting ongoing investigations of allegedly fraudulently obtained SBA guaranteed loans issued by Ciena. Specifically, on or about January 9, 2007, Ciena 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 alleged that a former Ciena employee in the Detroit office engaged in the fraudulent origination of loans guaranteed, in substantial part, by the SBA. We understand that Ciena is working cooperatively with the U.S. Attorney s Office and the investigating agencies with respect to this matter. On October 1, 2007, the former Ciena employee pled guilty to one count of conspiracy to fraudulently originate SBA-guaranteed loans and one count of making a false statement before a grand jury.

On March 6, 2007, Ciena entered into an agreement with the SBA. According to the agreement, Ciena 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, Ciena 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 the charges by the U.S. Attorney s Office for the Eastern District of Michigan against Mr. Harrington. Ciena also entered into an escrow agreement with the SBA and an escrow agent in which Ciena agreed to deposit $10 million with the escrow agent for any additional payments Ciena may be obligated to pay to the SBA in the future under the agreement. During the term of the agreement, any loans originated by Ciena that will be sold into the secondary market or loans that default after having been sold into the secondary market will be reviewed by an independent third party selected by the SBA prior to the sale of such loans into the secondary market or prior to reimbursement by the SBA. Ciena 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.

As an SBA lender, Ciena is also subject to other SBA and OIG audits, investigations, and reviews. In addition, the Office of the Inspector General of the U.S. Department of Agriculture is conducting an investigation of Ciena s lending practices under the Business and Industry Loan (B&I) program. The OIG and the U.S. Department of Justice are also conducting a civil investigation of Ciena s lending practices in various jurisdictions. These investigations, audits and reviews are ongoing.

On or about January 16, 2007, Ciena and its subsidiary 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). The complaint includes allegations arising under the False Claims Act and relating to alleged fraud in connection with SBA guarantees on shrimp vessel loans. On December 18, 2007, the United States District Court for the Northern District of Georgia dismissed all claims in this matter. The plaintiffs are appealing the dismissal.

These investigations, audits, reviews, and litigation have had and may continue to have a material adverse impact on Ciena and, as a result, could continue to negatively affect our financial results. We have considered Ciena s current regulatory issues, ongoing investigations, litigation, and the repositioning of its business in performing the valuation of Ciena at March 31, 2008, and December 31, 2007. See Results of Operations Valuation of Ciena Capital LLC below. We are monitoring the situation.

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, 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, or 5.0% of our total assets, which included unrealized appreciation of $159.9 million. We completed the purchase of a majority ownership in Mercury in April 2004.

In August 2007, we completed the sale of our majority equity interest in Mercury. For the year ended December 31, 2007, we realized a gain of $262.4 million, subject to post-closing adjustments. In addition, we were repaid approximately $51 million of subordinated debt outstanding to Mercury at closing.

Mercury owned and operated fixed base operations generally under long-term leases from local airport authorities, which consisted of terminal and hangar complexes that serviced the needs of the general aviation community. Mercury was headquartered in Richmond Heights, OH.

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

	Three Months Ended March 31,	Year Ended December 31		
	2007	**2007**	**2006**	**2005**
($ in millions)				
Interest income	$ 2.0	$ 5.1	$ 9.3	$ 8.8
Fees and other income	0.1	0.2	0.6	0.7
Total interest and related portfolio income	$ 2.1	$ 5.3	$ 9.9	$ 9.5

Net change in unrealized appreciation or depreciation for the three months ended March 31, 2007, included an increase in unrealized appreciation totaling $56.7 million related to our investment in Mercury. Net change in unrealized appreciation or depreciation for the year ended December 31, 2007, included an increase in unrealized appreciation totaling $74.9 million for the first half of 2007 and the reversal of

$234.8 million associated with the sale of our majority equity interest in the third quarter of 2007. Net change in unrealized appreciation or depreciation included a net increase in unrealized appreciation on our investment in Mercury of $106.1 million and $53.8 million for the years ended December 31, 2006 and 2005, respectively.

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. 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. 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 at closing. For the year ended December 31, 2006, we realized a gain on the sale of our equity investment of $434.4 million, subject to post-closing adjustments and excluding any earn-out amounts. We realized additional gains in 2008 and 2007, resulting from post-closing adjustments and an earn-out payment totaling $1.7 million and $3.4 million, respectively, subject to additional post-closing adjustments.

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, 2008, and December 31, 2007, the amount of the escrow included in other assets on our consolidated balance sheet was approximately $23 million and $25 million, respectively. 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 will generally allow 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.

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), and $37.4 million, for the years ended December 31, 2006, and 2005, 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 2006. Net change in unrealized appreciation or depreciation for the year ended December 31, 2006, included the reversal of $389.7 million of previously recorded unrealized appreciation associated with the realization of a gain on the sale of our majority equity interest in Advantage and for the year ended December 31, 2005, included an increase in unrealized appreciation of $378.4 million, related to our majority equity interest investment in Advantage.

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 resulted in a realized gain of $4.8 million.

Our investment in Advantage, which was composed of subordinated debt and a minority equity interest, totaled $155.7 million at cost and $167.6 million at value, which included unrealized appreciation of $11.9 million at March 31, 2008, and $154.8 million at cost and $165.8 million at value, which included unrealized appreciation of $11.0 million at December 31, 2007.

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, 2008 and 2007, and at and for the years ended December 31, 2007, 2006, and 2005, were as follows:

	At and for the Three Months Ended March 31,				At and for the Years Ended December 31,					
	2008		2007		2007		2006		2005	
($ in millions)	Value	Yield(1)	Value	Yield(1)	Value	Yield(1)	Value	Yield(1)	Value	Yield(1)
Portfolio at value:										
Commercial mortgage loans	$ 53.5	7.9%	$ 72.2	7.5%	65.4	6.8%	71.9	7.5%	102.6	7.6%
Real estate owned	30.2		21.0		21.3		19.6		13.9	
Equity interests	32.1		29.3		34.5		26.7		10.6	
Total portfolio	$ 115.8		$ 122.5		$ 121.2		$ 118.2		$ 127.1	
Investments funded	$ 0.5		$		$ 18.0		$ 14.4		$ 213.5	
Payment-in-kind interest, net of cash collections	$ 0.2		$ 0.2		$ (0.7)		$ 0.8		$ 0.0	
Principal collections related to investment repayments or sales (2)	$ 8.4		$ 0.4		$ 23.4		$ 39.9		$ 799.5	

(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 three months ended March 31, 2008 and for the years ended December 31, 2007, 2006, and 2005, were as follows:

	Face	Amount

($ in millions)	Amount	Discount	Funded
For the Three Months Ended March 31, 2008			
Commercial mortgage loans	$ 0.5	$	$ 0.5
Equity interests			
Total	$ 0.5		$ 0.5
For the Year Ended December 31, 2007			
Commercial mortgage loans	$ 17.0	$	$ 17.0
Equity interests	1.0		1.0
Total	$ 18.0	$	$ 18.0
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

[1] The CMBS bonds invested in during 2005 were sold on May 3, 2005.

At March 31, 2008, we had outstanding funding commitments related to the commercial real estate portfolio of $40.0 million, and commitments in the form of standby letters of credit and guarantees related to equity interests of $8.2 million.

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.

Simultaneous with the sale of our CMBS and CDO portfolio, we entered into a platform assets purchase agreement with CWCapital Investments LLC, an affiliate of the Caisse (CWCapital), pursuant to which we agreed to sell certain commercial real estate related assets, including servicer advances, intellectual property, software and other platform assets, subject to certain adjustments. Under this agreement, we agreed not to primarily invest in non-investment grade 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.

The real estate securities purchase agreement, under which we sold the CMBS and CDO portfolio, and the platform asset purchase agreement contain customary representations and warranties, and require us to indemnify the affiliates of the Caisse that are parties to the agreements for certain liabilities arising under the agreements, subject to certain limitations and conditions.

Managed Funds

We manage funds that invest in the debt and equity of primarily private middle market companies in a variety of industries (together, the Managed Funds). As of March 31, 2008 and December 31, 2007, the funds that we manage had total assets of approximately $1.2 billion and $400 million, respectively. During 2007, we established the Allied Capital Senior Debt Fund, L.P. and the Unitranche Fund LLC, and in the first quarter of 2008, we formed the AGILE Fund I, LLC, and assumed the management of Kinghtsbridge CLO 2007-1 Ltd., all discussed below. Our responsibilities to the Managed Funds may include deal origination, underwriting, and portfolio monitoring and development services consistent with the activities that we perform for our portfolio. Each of the Managed Funds may separately invest in the debt or equity of a portfolio company. Our portfolio may include debt or equity investments issued by the same portfolio company as investments held by one or more Managed Funds, and these investments may be senior, pari passu or junior to the debt and equity investments held by us. We may or may not participate in investments made by investment funds managed by us or one of our affiliates. We expect to continue to grow our managed capital base and have identified other private equity-related funds that we intend to develop. By growing our privately managed capital base, we are seeking to diversify our sources of capital, leverage our core investment expertise and increase fees and other income from asset management activities. See Risk Factors There are potential conflicts of interest between us and the funds managed by us.

Allied Capital Senior Debt Fund, L.P. The Allied Capital Senior Debt Fund, L.P. (ACSDF) is a private fund that generally invests in senior, unitranche and second lien debt. ACSDF has closed on $125 million in equity capital commitments and had total assets of approximately $432 million and $400 million at March 31, 2008 and December 31, 2007, respectively. AC Corp, our wholly-owned subsidiary, is the investment manager and Callidus acts as special manager to ACSDF. One of our affiliates is the general partner of ACSDF, and AC Corp serves as collateral manager to a warehouse financing vehicle associated with ACSDF. AC Corp will earn a management fee of up to 2% per annum of the net asset value of ACSDF and will pay Callidus 25% of that management fee to compensate Callidus for its role as special manager.

We are a special limited partner in ACSDF, which is a portfolio investment, and have committed and funded $31.8 million to ACSDF. At March 31, 2008, our investment in ACSDF totaled $31.8 million at cost and $32.6 million at value, and at December 31, 2007 totaled $31.8 million at cost and $32.8 million at value. As a special limited partner, we expect to earn an incentive allocation of 20% of ACSDF s annual net income earned in excess of a specified minimum return, subject to certain performance benchmarks. The value of our investment in ACSDF is based on the net asset value of ACSDF, which reflects the capital invested plus our allocation of the net earnings of ACSDF, including the incentive allocation.

We may offer to sell loans to ACSDF or the warehouse financing vehicle. ACSDF or the warehouse financing vehicle may purchase loans from us. In connection with ACSDF s formation in June 2007 and during the second half of 2007, we sold $224.2 million of seasoned assets with a weighted average yield of 10.0% to a warehouse financing vehicle associated with ACSDF. In the first quarter of 2008, we sold $30.0 million of seasoned assets with a weighted average yield of 8.2% to the warehouse financing vehicle. ACSDF also purchases loans from other third parties. In addition, during the second half of 2007, we repurchased one asset for $12.0 million from ACSDF, which we had sold to ACSDF in June 2007.

Unitranche Fund LLC. In December 2007, we formed the Unitranche Fund LLC (Unitranche Fund), which we co-manage with an affiliate of General Electric Capital Corporation (GE). The Unitranche Fund is a private fund that generally focuses on making first lien unitranche loans to middle market companies with EBITDA of at least $15 million. The Unitranche Fund may invest up to $270 million in a single borrower. For financing needs greater than $270 million, we and GE may jointly underwrite additional financing for a total unitranche financing of up to $500 million. Allied Capital, GE and the Unitranche Fund may co-invest in a single borrower, with the Unitranche Fund holding at least a majority of the issuance. GE has committed $3.075 billion to the Unitranche Fund consisting of $3.0 billion of senior notes and $0.075 billion of subordinated certificates and we have committed $525.0 million of subordinated certificates. The Unitranche Fund will be capitalized as transactions are completed. At March 31, 2008 the Unitranche Fund had total assets of approximately $142 million. At March 31, 2008 and December 31, 2007, our investment in the Unitranche Fund totaled $31.5 million at cost and at value and $0.7 million at cost and at value, respectively.

The Unitranche Fund is governed by an investment committee with equal representation from Allied Capital and GE and both Allied Capital and GE provide origination, underwriting and portfolio management services to the Unitranche Fund and its affiliates. We will earn a management and sourcing fee totaling 0.375% per annum of managed assets.

AGILE Fund I, LLC. In January 2008, we entered into an investment agreement with the Goldman Sachs Private Equity Group, part of Goldman Sachs Asset Management (Goldman Sachs). As part of the investment agreement, we agreed to sell a pro-rata strip of private equity and debt investments to AGILE Fund I, LLC (AGILE), a private fund in which a fund managed by Goldman Sachs owns substantially all of the interests, for a total transaction value of $167 million. The sales of the assets closed in the first quarter of 2008.

The sale to AGILE included 13.7% of our equity investments in 23 of our buyout portfolio companies and 36 of our minority equity portfolio companies for a total purchase price of $104 million, which resulted in a net realized gain of $8.8 million and dividend income of $5.4 million. In addition, we sold approximately $63 million in debt investments, which represented 7.3% of our unitranche, second lien and subordinated debt investments in the buyout investments included in the equity sale. AGILE generally has the right to co-invest in its proportional share of any future follow-on investment opportunities presented by the companies in its portfolio.

We are the managing member of AGILE, and are entitled to an incentive allocation subject to certain performance benchmarks. We own the remaining interests in AGILE not held by Goldman Sachs. At March 31, 2008, AGILE had total assets of approximately $174 million and our investment in AGILE totaled $0.9 million at cost and at value.

In addition, pursuant to the investment agreement Goldman Sachs has committed to invest at least $125 million in future investment vehicles managed by us and will have future opportunities to invest in our affiliates, or vehicles managed by them, and to coinvest alongside us in the future, subject to various terms and conditions.

As part of this transaction, we sold nine venture capital and private equity limited partnership investments for approximately $28 million to a fund managed by Goldman Sachs, which assumed the $4.7 million of unfunded commitments related to these limited partnership investments. The sales of these limited partnership investments closed at the end of the first quarter of 2008 and resulted in a net realized loss of $5.5 million.

Knightsbridge CLO 2007-1 Ltd. On March 31, 2008, we assumed the management of Knightsbridge CLO 2007-1 Ltd. We earn a management fee of up to 0.6% per annum of the assets of the fund. Callidus may assist us in the management of the fund and we may pay Callidus a portion of the management fee earned for this assistance. This CLO invests primarily in middle market senior loans. At March 31, 2008 Knightsbridge CLO 2007-1 Ltd. had total assets of approximately $500 million and our investment in this CLO totaled $54.4 million at cost and $53.0 million at value.

In aggregate, including the total assets on our balance sheet and capital committed to our Managed Funds, we have more than $9 billion in managed capital.

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, 2008, and December 31, 2007 and 2006, our portfolio was graded as follows:

	2008		**2007**		**2006**	
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	$ 1,301.7	28.1%	$ 1,539.6	32.2%	$ 1,307.3	29.1%
2	3,079.8	66.4	2,915.7	61.0	2,672.3	59.4
3	141.1	3.1	122.5	2.6	308.1	6.9
4	61.6	1.3	157.2	3.3	84.2	1.9
5	51.4	1.1	45.5	0.9	124.2	2.7
	$ 4,635.6	100.0%	$ 4,780.5	100.0%	$ 4,496.1	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. 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.

Total Grade 4 and 5 portfolio assets were $113.0 million, $202.7 million and $208.4 million, respectively, or were 2.4%, 4.2% and 4.6%, respectively, of the total portfolio value at March 31, 2008, December 31, 2007 and 2006. Grade 4 and 5 assets include loans, debt securities, and equity securities.

At March 31, 2008, and December 31, 2007, our Class A equity interests in Ciena, valued at $29.3 million and $68.6 million, respectively, were classified as Grade 5 and Grade 4, respectively, and our Class B and Class C equity interests, which had no value, were classified as Grade 5 at both periods. At December 31, 2006, $135.9 million of our investment in Ciena 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, and $74.8 million of our investment in Ciena at value was classified as Grade 5, which included certain of our Class B equity interests and all our Class C equity interests that were depreciated at December 31, 2006. See Private Finance Ciena Capital LLC above.

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

At March 31, 2008, and December 31, 2007 and 2006, loans and debt securities at value not accruing interest for the total investment portfolio were as follows:

($ in millions)	2008	2007	2006
Loans and debt securities in workout status (classified as Grade 4 or 5)[(1)]			
Private finance			
Companies more than 25% owned	$ 62.4	$ 114.1	$ 51.1
Companies 5% to 25% owned	2.6	11.7	4.0
Companies less than 5% owned	23.3	23.8	31.6
Commercial real estate finance	5.9	12.4	12.2
Loans and debt securities not in workout status			
Private finance			
Companies more than 25% owned	31.0	21.4	87.1
Companies 5% to 25% owned	12.3	13.4	7.2
Companies less than 5% owned	11.7	13.3	38.9
Commercial real estate finance	1.5	1.9	6.7
Total	$ 150.7	$ 212.0	$ 238.8
Percentage of total portfolio	3.3%	4.4%	5.3%

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

At March 31, 2008, and December 31, 2007 and 2006, our Class A equity interests in Ciena of $29.3 million, which represented 0.6% of the total portfolio at value, $68.6 million, which represented 1.4% of the total portfolio at value, and $66.6 million, which represented 1.5% of the total portfolio at value, respectively, were included in non-accruals. At March 31, 2008, these Class A equity interests were classified as Grade 5, at December 31, 2007, these Class A equity interests were classified as Grade 4 and at December 31, 2006, these Class A equity interests were classified as Grade 3. See Private Finance Ciena Capital LLC above.

Loans and Debt Securities Over 90 Days Delinquent. Loans and debt securities greater than 90 days delinquent at value at March 31, 2008, December 31, 2007 and 2006, were as follows:

	2008	2007	2006
($ in millions)			
Private finance	$ 54.0	$ 139.9	$ 46.5
Commercial mortgage loans	15.4	9.2	1.9
Total	$ 69.4	$ 149.1	$ 48.4
Percentage of total portfolio	1.5%	3.1%	1.1%

Loans and debt securities over 90 days delinquent at March 31,2008 and December 31, 2007, include our investment in the Class A equity interests of Ciena, which became over 90 days delinquent in the first quarter of 2007. The amount of loans and debt securities over 90 days delinquent increased from $48.4 million at December 31, 2006, to $149.1 million at December 31, 2007, primarily due to not receiving payment on our Class A equity interests of Ciena. At March 31, 2008, and December 31, 2007, the Class A equity interests were $29.3 million or 0.6% of the total portfolio at value and $68.6 million, or 1.4% of the total portfolio at value, respectively. These equity interests were placed on non-accrual during the fourth quarter of 2006. See Private Finance, Ciena Capital LLC above.

The amount of the portfolio that is on non-accrual status or greater than 90 days delinquent may vary from 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 $55.5 million, $149.1 million and $44.3 million at March 31, 2008, December 31, 2007 and 2006, respectively.

OTHER ASSETS AND OTHER LIABILITIES

Other assets is primarily composed of fixed assets, 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, 2008, and December 31, 2007 and 2006, other assets totaled $171.3 million, $157.9 million and $123.0 million, respectively. The increase in other assets since year end 2007 was primarily the result of an increase in accounts receivable due to $32.4 million in consideration received in connection with the sale of investments, which was received in cash in April 2008, partially offset by the March 2008 distribution of the assets held in deferred compensation trusts, which totaled $21.1 million at December 31, 2007.

Accounts payable and other liabilities is primarily composed of the liabilities related to accrued interest, bonus and taxes, including excise tax. At March 31, 2008, and December 31, 2007 and 2006, accounts payable and other liabilities totaled $62.3 million, $153.3 million and $147.1 million, respectively. The decrease in accounts payable and other liabilities since year end 2007 was primarily the result of the termination of the deferred compensation plans in March 2008, the liability for which totaled $52.5 million at December 31, 2007. In addition, accounts payable and other liabilities were reduced by the payment of liabilities at December 31, 2007, related to accrued 2007 bonuses of $40.1 million and excise tax of $16.0 million, offset by increases in the first quarter of 2008 related to accrued bonuses and excise tax totaling $12.6 million and interest payable totaling $11.5 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, 2008 and 2007

The following table summarizes our operating results for the three months ended March 31, 2008 and 2007.

(In thousands, except per share amounts)	For the Three Months Ended March 31, 2008	2007	Change	Percent Change
	(unaudited)			
Interest and Related Portfolio Income				
Interest and dividends	$ 134,660	$ 101,983	$ 32,677	32%
Fees and other income	10,284	5,969	4,315	72%
Total interest and related portfolio income	144,944	107,952	36,992	34%
Expenses				
Interest	37,560	30,288	7,272	24%
Employee	22,652	21,928	724	3%
Employee stock options	4,195	3,661	534	15%
Administrative	9,019	13,224	(4,205)	(32)%
Total operating expenses	73,426	69,101	4,325	6%
Net investment income before income taxes	71,518	38,851	32,667	84%
Income tax expense (benefit), including excise tax	1,969	(649)	2,618	403%
Net investment income	69,549	39,500	30,049	76%
Net Realized and Unrealized Gains (Losses)				
Net realized gains	3,143	27,666	(24,523)	*
Net change in unrealized appreciation or depreciation	(113,404)	65,920	(179,324)	*
Total net gains (losses)	(110,261)	93,586	(203,847)	*
Net income	$ (40,712)	$ 133,086	$ (173,798)	(131)%
Diluted earnings per common share	$ (0.25)	$ 0.87	$ (1.12)	(129)%
Weighted average common shares outstanding diluted	161,507	152,827	8,686	6%

* 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, 2008 and 2007, was composed of the following:

($ in millions)	2008	2007
Interest		
Private finance loans and debt securities	$ 107.0	$ 92.9
Preferred shares/income notes of CLOs	7.5	3.7
Subordinated certificates in Unitranche Fund LLC	0.3	
Commercial mortgage loans	1.2	1.3
Cash, U.S. Treasury bills, money market and other securities	1.8	2.8
Total interest	117.8	100.7
Dividends	16.9	1.3
Total interest and dividends	$ 134.7	$ 102.0

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, 2008 and 2007, were as follows:

	2008		2007	
($ in millions)	Value	Yield(1)	Value	Yield(1)
Loans and debt securities:				
Private finance	$ 3,411.8	12.2%	$ 3,091.3	11.7%
Commercial mortgage loans	53.5	7.9%	72.2	7.5%
Total loans and debt securities	3,465.3	12.1%	$ 3,163.5	11.6%
Equity securities:				
Preferred shares/income notes of CLOs	197.4	15.8%	96.1	13.5%
Subordinated certificates in Unitranche Fund LLC	31.5	12.4%		
Total	$ 3,694.2	12.3%	$ 3,259.6	11.7%

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

plus 7.5%) divided by (b) total investment at value. The weighted average yields are computed as of the balance sheet date.

Our interest income from our private finance loans and debt securities has increased period over period primarily as a result of the growth in this portfolio. The private finance loan and debt securities portfolio yield at March 31, 2008, of 12.2% as compared to the private finance portfolio yield of 11.7% at March 31, 2007, reflects the mix of debt investments in the private finance loan and debt securities 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 also includes the effective interest yield on our investments in the preferred shares/income notes of CLOs. Interest income from these investments has increased period over period primarily as a result of the growth in these assets. The weighted average yield on the preferred shares/income notes of the CLOs at March 31, 2008, was 15.8%, as compared to the weighted average yield on the preferred shares/income notes of the CLOs of 13.5% at March 31, 2007.

The value and weighted average yield of the cash, U.S. Treasury bills, money market and other securities was $201.6 million and 1.5%, respectively, at March 31, 2008, and $271.5 million and 5.3%, respectively, at March 31, 2007. See Financial Condition, Liquidity and Capital Resources below.

Dividend income results from the dividend yield on preferred equity interests, if any, or the declaration of dividends by a portfolio company on preferred or common equity interests. Dividend income for the three months ended March 31, 2008, was $16.9 million as compared to $1.3 million for the three months ended March 31, 2007. The increase period over period was primarily a result of a $7.1 million dividend received in connection with the recapitalization of Norwesco, Inc., a portfolio company, and $5.5 million of dividends paid in cash in connection with the sale to AGILE Fund I, LLC during the first quarter of 2008. See Portfolio and Investment Activity Managed Funds above. 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 and managed funds, 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, 2008 and 2007, included fees relating to the following:

($ in millions)	2008	2007
Structuring and diligence	$ 5.1	$ 1.8
Management, consulting and other services provided to portfolio companies	2.9	1.8
Commitment, guaranty and other fees from portfolio companies[1]	1.7	2.0
Fund management fees[2]	0.6	
Loan prepayment premiums		0.3
Other income		0.1
Total fees and other income	$ 10.3	$ 6.0

[1] Includes guaranty and other fees from Ciena of $1.4 million for 2007. See Private Finance, Ciena Capital, LLC above.

[2] See Portfolio and Investment Activity Managed Funds 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 and the level of assets in managed funds for which we earn management or other fees. 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 $274.6 million for the three months ended March 31, 2008, as compared to $170.2 million for the three months ended March 31, 2007. Structuring and diligence fees for the three months ended March 31, 2008, included $1.8 million earned by us in connection with investments made by the Unitranche Fund, LLC.

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.

See Portfolio and Investment Activity above for further information regarding our total interest related portfolio income for Ciena and Mercury.

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, 2008 and 2007, 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, 2008 and 2007, were as follows:

($ in millions)	**2008**	**2007**
Total outstanding debt	$ 2,191.6	$ 1,891.5
Average outstanding debt	$ 2,209.5	$ 1,841.2
Weighted average cost[1]	6.2%	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 $1.9 million and $0.3 million for the three months ended March 31, 2008 and 2007, respectively. Installment interest expense for the year ended December 31, 2008, is estimated to be a total of $7.7 million. See Dividends and Distributions below.

Employee Expense. Employee expenses for the three months ended March 31, 2008 and 2007, were as follows:

($ in millions)	**2008**	**2007**
Salaries and employee benefits	$ 22.7	$ 21.4
Individual performance award (IPA)	2.4	2.5
IPA mark to market expense (benefit)	(4.1)	(4.0)
Individual performance bonus (IPB)	1.7	2.0
Total employee expense[1]	$ 22.7	$ 21.9
Number of employees at end of period	186	170

(1) Excludes stock options expense. See below.

The change in salaries and employee benefits reflects the effect of an increase in the 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 $10.3 million and $10.4 million for the three months ended March 31, 2008 and 2007, respectively.

The IPA is an incentive compensation program for certain officers and is generally determined annually at the beginning of each year but may be adjusted throughout the year. Through December 31, 2007, the IPA was deposited in a deferred compensation trust in four equal installments, generally on a quarterly basis, in the form of cash. The trustee was required to use the cash to purchase shares of our common stock in the open market.

Through December 31, 2007, the IPA amounts were contributed into the trust and invested in our common stock. The accounts of the trust were consolidated with our accounts. The common stock was classified as common stock held in deferred compensation trust in the accompanying financial statements and the deferred compensation obligation, which represented the amount owed to the employees, was included in other liabilities. Changes in the value of our common stock held in the deferred compensation trust were not recognized. However, the liability was marked to market with a corresponding charge or credit to employee compensation expense. On March 18, 2008, prior to the distribution of the assets held in the trust, we were required to record a final mark to market of the liability with a corresponding credit to employee compensation expense.

In December 2007, our Board of Directors made a determination that it was in Allied Capital s best interest to terminate our deferred compensation arrangements. The Board of Directors decision was primarily in response to increased complexity resulting from recent changes in the regulation of deferred compensation arrangements. The Board of Directors resolved that the accounts under these Plans would be distributed to participants in full on March 18, 2008, the termination and distribution date, or as soon as was reasonably practicable thereafter, in accordance with the provisions of each of these Plans.

The accounts under the deferred compensation arrangements totaled $52.5 million at December 31, 2007. The balances on the termination date were distributed to participants in March 2008 subsequent to the termination date, in accordance with the transition rule for payment elections under Section 409A of the Code. Distributions from the plans were made in cash or shares of our common stock, net of required withholding taxes. The distribution of the accounts under the deferred compensation arrangements will result in a tax deduction for 2008, subject to the limitations set by Section 162(m) of the Code for persons subject to such section.

The IPB is distributed in cash to award recipients throughout the year (beginning in February of each respective 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 2008 and they are currently estimated to be approximately $9.5 million each; however, the Compensation Committee may adjust the IPA or IPB as needed, or make new awards as new officers are hired. For 2008, the Compensation Committee has determined that the IPAs will be paid in cash in two equal installments during the year, as long as the recipient remains employed by us. 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.

Stock Options Expense. Effective January 1, 2006, we adopted FASB Statement No. 123 (Revised 2004), *Share-Based Payment* (SFAS 123R) 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 SFAS 123R. With respect to options granted on or after January 1, 2006, compensation cost based on estimated grant date fair value is recognized in the consolidated statement of operations over the service period. Our employee stock options are typically granted with ratable vesting provisions, and we amortize the compensation cost over the related service period. On February 1, 2008, the Compensation Committee of our Board of Directors granted 7.1 million options with an exercise price of $22.96 per share. The options vest ratably over a three-year period beginning on June 30, 2009.

The stock option expense for the three months ended March 31, 2008 and 2007, was as follows:

($ in millions)	2008	2007
Employee Stock Option Expense:		
Previously awarded, unvested options as of January 1, 2006	$ 1.7	$ 3.2
Options granted on or after January 1, 2006	2.5	0.5
Total employee stock option expense	$ 4.2	$ 3.7

We estimate that the employee-related stock option expense for outstanding unvested options as of March 31, 2008, will be approximately $13.2 million, $6.8 million, and $4.0 million for the years ended December 31, 2008, 2009, and 2010, respectively. This estimate may change if our assumptions related to future option forfeitures change. This estimate does not include any expense related to stock option grants after March 31, 2008, 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, 2008 and 2007, were $9.0 million and $13.2 million, respectively. Administrative expenses declined due to a reduction in investigation and litigation costs, net of insurance reimbursements, of $3.8 million. Administrative expenses for the three months ended March 31, 2007, included costs of $1.4 million incurred to engage a third party to conduct a review of Ciena s internal control systems. See Private Finance, Ciena Capital LLC above.

Income Tax Expense (Benefit), Including Excise Tax. Income tax expense (benefit) for the three months ended March 31, 2008 and 2007, was as follows:

($ in millions)	2008	2007
Income tax expense (benefit)	$ (0.3)	$ (4.2)
Excise tax expense[1]	2.3	3.6
Income tax expense (benefit), including excise tax	$ 2.0	$ (0.6)

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

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

Our excess taxable income carried over from 2007 plus our estimated annual taxable income for 2008 currently exceeds our estimated dividend distributions to shareholders in 2008, therefore, we expect to carry over excess taxable income earned in 2008 for distribution in 2009. Therefore, 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 for the year. We have recorded an estimated excise tax of $2.3 million for the three months ended March 31, 2008. See Dividends and Distributions.

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, 2008 and 2007, were as follows:

($ in millions)	2008	2007
Realized gains	$ 32.7	$ 33.2
Realized losses	(29.6)	(5.5)
Net realized gains	$ 3.1	$ 27.7

The realized gains and losses for the three months ended March 31, 2008, were primarily a result of the sale to AGILE Fund I, LLC. The net realized gain from this transaction totaled $8.8 million. In addition, realized losses for the quarter included $5.5 million related to the sale of the venture capital and private equity limited partnership investments to a fund managed by Goldman Sachs. See Managed Funds above.

When we exit an investment and realize a gain or loss or receive a dividend on an equity security from a portfolio company, 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, 2008 and 2007, we reversed previously recorded unrealized appreciation or depreciation when gains or losses were realized or when dividends were received as follows:

($ in millions)	2008	2007
Reversal of previously recorded net unrealized appreciation associated with realized gains	$ (32.5)	$ (32.1)
Reversal of previously recorded net unrealized appreciation associated with dividends received	(13.5)	
Reversal of previously recorded net unrealized depreciation associated with realized losses	28.5	5.8
Total reversal	$ (17.5)	$ (26.3)

Realized gains for the three months ended March 31, 2008 and 2007, were as follows:

($ in millions)

2008	
Portfolio Company	**Amount**
Private Finance:	
Norwesco, Inc.	$ 10.7
BenefitMall, Inc.	4.9
Financial Pacific Company	3.1
Penn Detroit Diesel Allison, LLC	1.7
Service Champ, Inc.	1.7
Advantage Sales & Marketing, Inc.[1]	3.2
Coverall North America, Inc.	1.4
CR Holding, Inc.	1.0
Other	4.9

Total private finance		32.6
Commercial Real Estate:		
Other		0.1
Total commercial real estate		0.1
Total realized gains	$	32.7

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

(1) Includes an additional realized gain of $1.7 million related to the release of escrowed funds from the sale of our majority equity investment in 2006.

Realized losses for the three months ended March 31, 2008 and 2007, were as follows:
($ in millions)

2008

Portfolio Company		**Amount**
Private Finance:		
Crescent Equity Corp. Longview Cable & Data, LLC	$	8.4
Mid-Atlantic Venture Fund IV, L.P.		5.2
WMA Equity Corporation and Affiliates		4.5
Driven Brands, Inc.		1.9
Direct Capital Corporation		1.7
EarthColor, Inc.		1.7
Sweet Traditions, Inc.		1.0
Other		4.9
Total private finance		29.3
Commercial Real Estate:		
Other		0.3
Total commercial real estate		0.3
Total realized losses	$	29.6

2007

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

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 (1940 Act), is (i) the market price for those securities for which a market quotation is readily available and (ii) for all other securities and assets, fair value is as determined in good faith by the Board of Directors. Since there is typically no readily available market value for the investments in our portfolio, we value substantially all of our portfolio investments at fair value as determined in good faith by the Board of Directors in accordance with our valuation policy and the provisions of the 1940 Act and FASB Statement No. 157, *Fair Value Measurements* (SFAS 157 or the Statement). We determine fair value to be the price that would be received for an investment in a current sale, which assumes an orderly transaction between market participants on the measurement date. At March 31, 2008, portfolio investments recorded at fair value using level 3 inputs (as defined under the Statement) were approximately 91% of our total assets. Because of the inherent uncertainty of determining the fair value of investments that do not have a readily available market quotation in an active market, the fair value of our investments determined in good faith by the Board of Directors may differ significantly from the values that would have been used had a ready market existed for the investments, and the differences could be material.

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

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

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

Valuation Methodology. We adopted SFAS 157 on a prospective basis in the first quarter of 2008. SFAS 157 requires us to assume that the portfolio investment is assumed to be sold in the principal market to market participants, or in the absence of a principal market, the most advantageous market, which may be a hypothetical market. Market participants are defined as buyers and sellers in the principal or most advantageous market that are independent, knowledgeable, and willing and able to transact. In accordance with the Statement, we have considered our principal market, or the market in which we exit our portfolio investments with the greatest volume and level of activity.

We have determined that for our buyout investments, where we have control or could gain control through an option or warrant security, both the debt and equity securities of the portfolio investment would exit in the merger and acquisition (M&A) market as the principal market generally through a sale or recapitalization of the portfolio company. We believe that the in-use premise of value (as defined in SFAS 157), which assumes the debt and equity securities are sold together, is appropriate as this would provide maximum proceeds to the seller. As a result, we will continue to use the enterprise value methodology to determine the fair value of these investments under SFAS 157. Enterprise value means the entire value of the company to a market participant, including the sum of the values of debt and equity securities used to capitalize the enterprise at a point in time. Enterprise value is determined using various factors, including cash flow from operations of the portfolio company, multiples at which private companies are bought and sold, and other pertinent factors, such as recent offers to purchase a portfolio company, recent transactions involving the purchase or sale of the portfolio company s equity securities, liquidation events, or other events. We allocate the enterprise value to these securities in order of the legal priority of the securities.

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

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

While we typically exit our securities upon the sale or recapitalization of the portfolio company in the M&A market, for investments in portfolio companies where we do not have control or the ability to gain control through an option or warrant security, we cannot typically control the exit of our investment into the principal market (the M&A market). As a result, in accordance with SFAS 157, we are required to determine the fair value of these investments assuming a sale of the individual investment in a hypothetical market to a hypothetical market participant (the in-exchange premise of value). We continue to perform an enterprise value analysis for investments in this category to assess the credit risk of the loan or debt security and to determine the fair value of our equity investment in these portfolio companies. The determined equity values are generally discounted when we have a minority ownership position, restrictions on resale, specific concerns about the receptivity of the capital markets to a specific company at a certain time, or other factors. For loan and debt securities, we perform a yield analysis assuming a hypothetical current sale of the investment. The yield analysis requires us to estimate the expected repayment date of the instrument and a market participant s required yield. Our estimate of the expected repayment date of a loan or debt security is generally shorter than the legal maturity of the instruments as our loans have historically been repaid prior to the maturity date. The yield analysis considers changes in interest rates and changes in leverage levels of the loan or debt security as compared to market interest rates and leverage levels. Assuming the credit quality of the loan or debt security remains stable, we will use the value determined by the yield analysis as the fair value for that security. A change in the assumptions that we use to estimate the fair value of our loans and debt securities using the yield analysis could have a material impact on the determination of fair value. If there is deterioration in credit quality or a loan or debt security is in workout status, we may consider other factors in determining the fair value of a loan or debt security, including the value attributable to the loan or debt security from the enterprise value of the portfolio company or the proceeds that would be received in a liquidation analysis.

Our equity investments in private debt and equity funds are generally valued at the fund s net asset value, unless other factors lead to a determination of fair value at a different amount. The value of our equity securities in public companies for which quoted prices in an active market are readily available is based on the closing public market price on the measurement date.

The fair value of our CLO/ CDO Assets is generally based on a discounted cash flow model that utilizes prepayment, re-investment 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 CLO/ CDO Assets as comparable yields in the market change and/or based on changes in estimated cash flows resulting from changes in prepayment, re-investment or loss assumptions in the underlying collateral pool. We determine the fair value of our CLO/ CDO Assets on an individual security-by-security basis. If we were to sell a group of these CLO/ CDO Assets in a pool in one or more transactions, the total value received for that pool may be different than the sum of the fair values of the individual assets.

We will record unrealized depreciation on investments when we determine that the fair value of a security is less than its cost basis, and will record unrealized appreciation when we determine that the fair value is greater than its cost basis. Because of the inherent uncertainty of valuation, the values determined at the measurement date may differ significantly from the values that would have been used had a ready market existed for the investments, and the differences could be material. Additionally, changes in the market environment and other events that may occur over the life of the investments may cause the gains or losses ultimately realized on these investments to be different than the values determined at the measurement date.

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

The valuation analysis prepared by management is submitted to our Board of Directors who is ultimately responsible for the determination of fair value of the portfolio in good faith. Valuation assistance from Duff & Phelps, LLC (Duff & Phelps) for our private finance portfolio consisted of certain limited procedures (the Procedures) we identified and requested them to perform. Based upon the performance of the Procedures on a selection of our final portfolio company valuations, Duff & Phelps concluded that the fair value of those portfolio companies subjected to the Procedures did not appear unreasonable. In addition, we also received third-party valuation assistance from other third-party consultants for certain private finance portfolio companies. For the three months ended March 31, 2008 and 2007, we received third-party valuation assistance as follows:

	2008	**2007**
Number of private finance portfolio companies reviewed	124	88
Percentage of private finance portfolio reviewed at value	94.0%	91.8%

Professional fees for third-party valuation assistance were $1.8 million for the year ended December 31, 2007, and are estimated to be approximately $2.3 million for 2008.

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

($ in millions)	**2008[(1)]**	**2007[(1)]**
Net unrealized appreciation (depreciation)	$ (95.9)	$ 92.2
Reversal of previously recorded unrealized appreciation associated with realized gains	(32.5)	(32.1)
Reversal of previously recorded net unrealized appreciation associated with dividends received	(13.5)	
Reversal of previously recorded unrealized depreciation associated with realized losses	28.5	5.8

Net change in unrealized appreciation or depreciation	$	(113.4)	$	65.9

(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.

The primary drivers of the net unrealized depreciation of $95.9 million resulting from changes in portfolio value for the quarter ended March 31, 2008, were (i) non-buyout debt investments, which depreciated by $9.3 million as a result of using a yield analysis in connection with the adoption of SFAS 157, (ii) additional depreciation of $39.3 million on our investment in Ciena resulting from the decline in value of their residual interest assets and other financial assets as discussed below, and (iii) depreciation in our other financial services and asset management portfolio companies, and our CLO/ CDO investments, which totaled $39.4 million.

Valuation of Ciena Capital LLC. Our investment in Ciena totaled $327.8 million at cost and $29.3 million at value, which included unrealized depreciation of $298.5 million, at March 31, 2008, and $327.8 million at cost and $68.6 million at value, which included unrealized depreciation of $259.2 million, at December 31, 2007.

Ciena relies on the asset-backed securitization market to finance its loan origination activity. That financing source continues to be unreliable in the current capital markets, and as a result, Ciena has substantially curtailed loan origination activity. To value our investment at March 31, 2008, we continued to attribute no value to Ciena s origination platform or enterprise due to the state of the securitization markets, among other factors. The decline in value at March 31, 2008, of $39.3 million reflects the decline in value of Ciena s financial assets, including residual interests, which reduced its book value. We valued our investment in Ciena at March 31, 2008, solely based on the estimated realizable value of Ciena s net assets, including the estimated realizable value of the cash flows generated from Ciena s retained interests in its current servicing portfolio, which includes portfolio servicing fees as well as cash flows from Ciena s equity investments in its securitizations and its interest-only strip. This resulted in a value to our investment, after repayment of senior debt outstanding, of $29.3 million at March 31, 2008.

We also continued to consider Ciena s current regulatory issues and ongoing investigations and litigation in performing the valuation analysis at March 31, 2008. (See Private Finance, Ciena Capital LLC above.)

Net change in unrealized appreciation or depreciation included a net decrease of $39.3 million for the three months ended March 31, 2008, and no change for the three months ended March 31, 2007. We received valuation assistance from Duff & Phelps for our investment in Ciena at March 31, 2008 and 2007. See Valuation Methodology Private Finance above for further discussion of the third-party valuation assistance we received.

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 161.5 million and 152.8 million for the three months ended March 31, 2008 and 2007, respectively.

Comparison of the Years Ended December 31, 2007, 2006, and 2005

The following table summarizes our operating results for the years ended December 31, 2007, 2006, and 2005.

(in thousands, except per share amounts)	2007	2006	Change	Percent Change	2006	2005	Change	Percent Change
Interest and Related Portfolio Income								
Interest and dividends	$ 417,576	$ 386,427	$ 31,149	8%	$ 386,427	$ 317,153	$ 69,274	22%
Fees and other income	44,129	66,131	(22,002)	(33)%	66,131	56,999	9,132	16%
Total interest and related portfolio income	461,705	452,558	9,147	2%	452,558	374,152	78,406	21%
Expenses								
Interest	132,080	100,600	31,480	31%	100,600	77,352	23,248	30%
Employee	89,155	92,902	(3,747)	(4)%	92,902	78,300	14,602	19%
Employee stock options	35,233	15,599	19,634	126%	15,599		15,599	
Administrative	50,580	39,005	11,575	30%	39,005	69,713	(30,708)	(44)%
Total operating expenses	307,048	248,106	58,942	24%	248,106	225,365	22,741	10%
Net investment income before income taxes	154,657	204,452	(49,795)	(24)%	204,452	148,787	55,665	37%
Income tax expense, including excise tax	13,624	15,221	(1,597)	(10)%	15,221	11,561	3,660	32%
Net investment income	141,033	189,231	(48,198)	(25)%	189,231	137,226	52,005	38%
Net Realized and Unrealized Gains (Losses)								
Net realized gains	268,513	533,301	(264,788)	(50)%	533,301	273,496	259,805	95%
Net change in unrealized appreciation or depreciation	(256,243)	(477,409)	221,166	*	(477,409)	462,092	(939,501)	*

Total net gains (losses)	12,270	55,892	(43,622)	*	55,892	735,588	(679,696)	*
Net income	$ 153,303	$ 245,123	$ (91,820)	(37)%	$ 245,123	$ 872,814	$ (627,691)	(72)%
Diluted earnings per common share	$ 0.99	$ 1.68	$ (0.69)	(41)%	$ 1.68	$ 6.36	$ (4.68)	(74)%
Weighted average common shares outstanding diluted	154,687	145,599	9,088	6%	145,599	137,274	8,325	6%

* 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, 2007, 2006, and 2005, was composed of the following:

($ in millions)	2007	2006	2005
Interest			
Private finance loans and debt securities	$ 376.1	$ 348.4	$ 247.8
Preferred shares/income notes of CLOs	18.0	11.5	3.2
CMBS and real estate-related CDO portfolio			29.4
Commercial mortgage loans	6.4	8.3	7.6
Cash, U.S. Treasury bills, money market and other securities	15.1	14.0	9.4
Total interest	415.6	382.2	297.4
Dividends	2.0	4.2	19.8
Total interest and dividends	$ 417.6	$ 386.4	$ 317.2

The level of interest income, which includes interest paid in cash and in kind, is directly related to the balance of the interest-bearing investment portfolio outstanding during the year multiplied by the weighted average yield. The interest-bearing investments in the portfolio at value and the yield on the interest-bearing investments in the portfolio at December 31, 2007, 2006, and 2005, were as follows:

	2007		2006		2005	
($ in millions)	Value	Yield(1)	Value	Yield(1)	Value	Yield(1)
Loans and debt securities:						
Private finance	$ 3,414.6	12.1%	$ 3,185.2	11.9%	$ 2,094.9	13.0%
Commercial mortgage loans	65.4	6.8%	71.9	7.5%	102.6	7.6%
Total loans and debt securities	3,480.0	12.0%	3,257.1	11.8%	2,197.5	12.8%
Equity securities:						
Preferred shares/income notes of CLOs	203.0	14.6%	97.2	15.5%	72.3	13.7%
Total interest bearing securities	$ 3,683.0	12.1%	$ 3,354.3	11.9%	$ 2,269.8	12.8%

(1) The weighted average yield on loans and debt securities is computed as the (a) annual stated interest on accruing loans and debt securities plus the annual amortization of loan origination fees, original issue discount, and market discount on accruing loans and debt securities less the annual amortization of loan origination costs, divided by (b) total interest-bearing investments at value. The weighted average yield on the preferred shares/income notes of

CLOs is calculated as the (a) effective interest yield on the preferred shares/income notes of CLOs, divided by (b) preferred shares/income notes of CLOs at value. The weighted average yields are 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. The private finance loan and debt securities portfolio yield at December 31, 2007, of 12.1% as compared to the private finance portfolio yield of 11.9% and 13.0% at December 31, 2006 and 2005, respectively, reflects the mix of debt investments in the private finance loan and debt securities 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.

Interest income also includes the effective interest yield on our investments in the preferred shares/income notes of CLOs. Interest income from these investments has increased year over year primarily as a result of the growth in these assets. The weighted average yield on the preferred shares/income notes of the CLOs at December 31, 2007, was 14.6%, as compared to the weighted average yield on the preferred shares/income notes of the CLOs yield of 15.5% and 13.7% at December 31, 2006 and 2005, respectively.

There was no interest income from the CMBS and real estate-related CDO portfolio in 2007 or 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.

Interest income from cash, U.S. Treasury bills, money market and other securities results primarily from interest earned on our liquidity portfolio and excess cash on hand. During the fourth quarter of 2005, we established a liquidity portfolio that was composed primarily of money market and other securities and U.S. Treasury bills. At December 31, 2007, the liquidity portfolio was composed primarily of money market securities. See Financial Condition, Liquidity and Capital Resources below. The value and weighted average yield of the liquidity portfolio was $201.2 million and 4.6%, respectively, at December 31, 2007, $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 years ended December 31, 2007 and 2006, did not include any dividends from Ciena. See Private Finance, Ciena Capital LLC above. Dividend income for the year ended December 31, 2005, included dividends from Ciena on the Class B equity interests held by us of $14.0 million. 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.

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, 2007, 2006, and 2005, included fees relating to the following:

($ in millions)	2007	2006	2005
Structuring and diligence	$ 20.7	$ 37.3	$ 24.6
Management, consulting and other services provided to portfolio companies[1]	9.6	11.1	14.4
Commitment, guaranty and other fees from portfolio companies[2]	9.3	8.8	9.3
Fund management fees[3]	0.5		
Loan prepayment premiums	3.7	8.8	6.3
Other income	0.3	0.1	2.4
Total fees and other income[4]	$ 44.1	$ 66.1	$ 57.0

(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 includes $6.5 million in management fees from Advantage. 2006 and 2005 included management fees from Ciena of $1.7 million and $2.9 million, respectively. We did not charge Ciena management fees in 2007 or in the fourth quarter of 2006. See Private Finance Ciena

Capital LLC above.

(2) Includes guaranty and other fees from Ciena of $5.4 million, $6.1 million, and $6.3 million for 2007, 2006, and 2005, respectively. See Private Finance Ciena Capital LLC above.

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

(4) Fees and other income related to the CMBS and CDO portfolio were $4.1 million for 2005. 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, the types of services provided and the level of assets in managed funds for which we earn management or other fees. 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 $1.8 billion for the year ended December 31, 2007, as compared to $2.4 billion and $1.5 billion for the years ended December 31, 2006 and 2005, respectively. This resulted in lower structuring and diligence fees in 2007 versus 2006.

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.

See Portfolio and Investment Activity above for further information regarding our total interest and related portfolio income for Ciena, Mercury, 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, 2007, 2006, and 2005, 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, 2007, 2006, and 2005, were as follows:

($ in millions)	**2007**	**2006**	**2005**
Total outstanding debt	$ 2,289.5	$ 1,899.1	$ 1,284.8
Average outstanding debt	$ 1,924.2	$ 1,491.0	$ 1,087.1
Weighted average cost[1]	6.5%	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 $5.8 million, $0.9 million, and $0.6 million for the years ended December 31, 2007, 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 and $1.4 million for the years ended December 31, 2006 and 2005, respectively.

Employee Expense. Employee expenses for the years ended December 31, 2007, 2006, and 2005, were as follows:

($ in millions)	2007	2006	2005
Salaries and employee benefits	$ 83.9	$ 73.8	$ 57.3
Individual performance award (IPA)	9.8	8.1	7.0
IPA mark to market expense (benefit)	(14.0)	2.9	2.0
Individual performance bonus (IPB)	9.5	8.1	6.9
Transition compensation, net(1)			5.1
Total employee expense(2)	$ 89.2	$ 92.9	$ 78.3
Number of employees at end of period	177	170	131

(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.

(2) Excludes stock options expense. See below.

The change in salaries and employee benefits reflects the effect of compensation increases, the change in mix of employees given their area of responsibility and relevant experience level and an increase in the number of employees. The overall increase in salaries and employee benefits 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 $40.1 million, $38.2 million, and $26.9 million for the years ended December 31, 2007, 2006, and 2005, respectively.

The IPA is an incentive compensation program for certain officers and is generally determined annually at the beginning of each year. Through December 31, 2007, the IPA was deposited into a deferred compensation trust generally in four equal installments, on a quarterly basis, in the form of cash. The trustee was 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 has been deferred compensation, the cost of this award is not a current expense for purposes of computing our taxable income until distributions are made from the trust.

On December 14, 2007, our Board of Directors made a determination that it is in Allied Capital s best interest to terminate our deferred compensation plans. The Board of Directors decision was primarily in response to increased complexity resulting from recent changes in the regulation of deferred compensation arrangements. The Board of Directors resolved that our deferred compensation plans would be terminated in accordance with the provisions of each of the plans and the accounts under the plans would be distributed to participants in full on March 18, 2008, the termination and distribution date, or as soon as reasonably practicable thereafter, in accordance with the transition rule for payment elections under Section 409A of the Internal Revenue Code of 1986. The termination and distribution of the plans was completed in the first quarter of 2008. Distributions from the plans were made in cash or shares of our common stock, net of required withholding taxes. See Results of Operations Comparison of the Three Months Ended March 31, 2008 and 2007 Employee Expense above. See also Compensation of Executive Officers and Directors Termination of Deferred Compensation Arrangements.

The assets of the rabbi trust related to The Allied Capital Corporation Non-Qualified Deferred Compensation Plans (DCPs I) were primarily invested in assets other than shares of our common stock. At December 31, 2007, the liability to participants related to DCPs I was valued at $21.1 million in the aggregate, and that liability is fully funded by assets held in the rabbi trust.

The assets of the rabbi trust related to The Allied Capital Corporation Non-Qualified Deferred Compensation Plans II(DCPs II) were primarily invested in shares of our common stock. At

December 31, 2007, the liability to participants related to DCPs II was valued at $31.4 million in the aggregate, and that liability was fully funded by assets held in the rabbi trust. At December 31, 2007, the DCPs II rabbi trust held approximately 1.4 million shares of our common stock.

The account balances in the plans accumulated as a result of prior compensation earned by the participants. The contributions to the plans reflect a combination of participant elective compensation deferrals and non-elective employer contributions, including contributions related to previously earned individual performance awards. The distribution of the DCPs I and DCPs II assets will result in a tax deduction for 2008, subject to the limitations set by Section 162(m) of the Code for persons subject to such section.

The IPB is distributed in cash to award recipients throughout the year (beginning in February of each respective year) as long as the recipient remains employed by us.

The Compensation Committee of the Board of Directors and the Board of Directors have determined the IPA and the IPB for 2008 and they are currently estimated to be approximately $9.6 million each; however, the Compensation Committee may adjust the IPA or IPB as needed, or make new awards as new officers are hired. For 2008, the Compensation Committee has determined that the IPAs will be paid in cash in two equal installments during the year, as long as the recipient remains employed by us. If a recipient terminates employment during the year, any remaining payments under the IPA or IPB would be forfeited.

Stock Options Expense. Effective January 1, 2006, we adopted Statement No. 123 (Revised 2004), *Share-Based Payment* (SFAS 123R) 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, will be recognized over the remaining service period in the statement of operations beginning in 2006, using the fair value amounts determined for proforma disclosure under SFAS 123R. With respect to options granted on or after January 1, 2006, compensation cost based on estimated grant date fair value is recognized in the consolidated statement of operations over the service period. Our employee stock options are typically granted with ratable vesting provisions, and we amortize the compensation cost over the related service period. The stock option expense for the years ended December 31, 2007 and 2006, was as follows:

($ in millions)	**2007**	**2006**
Employee Stock Option Expense:		
Options granted:		
Previously awarded, unvested options as of January 1, 2006	$ 10.1	$ 13.2
Options granted on or after January 1, 2006	10.7	2.4
Total options granted	20.8	15.6
Options cancelled in connection with tender offer (see below)	14.4	
Total employee stock option expense	$ 35.2	$ 15.6

Options Granted. In addition to the employee stock option expense for both options granted, for both the years ended December 31, 2007 and 2006, administrative expense included $0.2 million of expense related to options granted to directors during each year. Options were granted to non-officer directors in the second quarters of 2007 and 2006. Options granted to non-officer directors vest on the grant date and therefore, the full expense is recorded on the grant date.

During the second quarter of 2007, options were granted for 6.4 million shares. One-third of the options granted to employees vested on June 30, 2007; therefore, approximately one-third of the expense related to this grant, or $5.9 million, was recorded in the second quarter of 2007. Of the remaining options granted, one-half will vest on June 30, 2008, and one-half will vest on June 30, 2009. See Results of Operations for the Three Months Ended

March 31, 2008 and 2007 Stock Options Expense above for the estimate of employee-related stock option expense for future periods.

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

The OCP was equal to the in-the-money value of the stock options cancelled, determined using the Weighted Average Market Price of $31.75, and was paid one-half in cash and one-half in unregistered shares of the Company s common stock. In accordance with the terms of the tender offer, the Weighted Average Market Price represented the volume weighted average price of our common stock over the fifteen trading days preceding the first day of the offer period, or June 20, 2007. Because the Weighted Average Market Price at the commencement of the tender offer on June 20, 2007, was higher than the market price of our common stock at the close of the offer on July 18, 2007, SFAS 123R required us to record a non-cash employee-related stock option expense of $14.4 million and administrative expense related to stock options cancelled that were held by non-officer directors of $0.4 million. The same amounts were recorded as an increase to additional paid-in capital and, therefore, had no effect on our net asset value. The portion of the OCP paid in cash of $52.8 million reduced our additional paid-in capital and therefore reduced our net asset value. For income tax purposes, our tax deduction resulting from the OCP will be similar to the tax deduction that would have resulted from an exercise of stock options in the market. Any tax deduction resulting from the OCP or an exercise of stock options in the market is limited by Section 162(m) of the Code.

Administrative Expense. Administrative expenses include legal and accounting fees, valuation assistance fees, insurance premiums, the cost of leases for our headquarters in Washington, DC, and our regional offices, portfolio origination and development expenses, travel costs, stock record expenses, directors fees and related stock options expense, and various other expenses. Administrative expenses for the years ended December 31, 2007, 2006, and 2005, were as follows:

($ in millions)	**2007**	**2006**	**2005**
Administrative expenses	$ 44.8	$ 34.0	$ 33.3
Investigation and litigation costs	5.8	5.0	36.4
Total administrative expenses	$ 50.6	$ 39.0	$ 69.7

Administrative expenses, excluding investigation and litigation costs, for the year ended December 31, 2007, included costs of $1.4 million incurred in the first quarter of 2007 to engage a third party to conduct a review of Ciena s internal control systems. See Private Finance, Ciena Capital LLC above. In addition, administrative expenses for the year ended December 31, 2007, included $2.5 million in placement fees related to securing equity commitments to the Allied Capital Senior Debt Fund, L.P. in the second quarter of 2007. See Managed Funds Allied Capital Senior Debt Fund, L.P. above.

Administrative expenses, excluding investigation and litigation costs and the costs outlined above, were $40.9 million for the year ended December 31, 2007, which is an increase of $6.9 million from 2006. The increase was primarily due to increased expenses related to directors fees of $1.6 million, an increase in stock record expenses of $0.7 million due to the increase in our shareholder base, an increase in rent expense of $0.7 million, and an increase in costs related to evaluating potential new investments of $0.7 million. Costs related to debt investments are generally paid by the borrower, however, costs related to buyout investments are generally funded by us. Accordingly, if a prospective deal does not close, we incur expenses that are not recoverable.

Investigation and litigation costs are difficult to predict and may vary from year to year. See Legal Proceedings below.

Income Tax Expense, Including Excise Tax. Income tax expense for the years ended December 31, 2007, 2006, and 2005, was as follows:

($ in millions)	**2007**	**2006**	**2005**
Income tax expense (benefit)	$ (2.7)	$ 0.1	$ 5.4
Excise tax expense[1]	16.3	15.1	6.2
Income tax expense, including excise tax	$ 13.6	$ 15.2	$ 11.6

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

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

Our estimated annual taxable income for 2007 exceeded our 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 an excise tax equal to 4% of the amount by which 98% of our annual taxable income exceeds the distributions for the year. We have recorded an estimated excise tax of $16.3 million for the year ended December 31, 2007. See Dividends and Distributions.

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. In 2005, net realized gains also resulted from the sale of real estate-related CMBS bonds and CDO bonds and preferred shares. Net realized gains for the years ended December 31, 2007, 2006, and 2005, were as follows: