

Edgar Filing: - Form

Form

Unknown document format

T size="2"> Loan (12.0%, Due 12/06) 825 825

(Financial Services)

Debt Securities (18.0%, Due 10/08) 3,710 3,710 Common Stock (10 shares) 1,768 1,768

---

Chickasaw Sales & Marketing, Inc.

Preferred Stock (1,000,000 shares) 1,000

(Consumer Services)

Common Stock (37,000 shares) 2,812

---

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

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

(3) Public company.

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

(5) Non-registered investment company.

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

F-6

---

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

(Information at June 30, 2004, is unaudited)

Private Finance Portfolio Company (in thousands, except number of shares)	Investment <sup>(1)(2)</sup>	June 30, 2004	
		Cost	(unaudited) Value
The Color Factory, Inc. (Consumer Products)	Loan (12.0%, Due 6/06) Preferred Stock (1,000 shares) Common Stock (980 shares) Guaranty (\$283)	\$16,489 1,002 6,535	\$ 1,540
Foresite Towers, LLC (Tower Leasing)	Equity Interests	18,610	20,648
Global Communications, LLC (Business Services)	Loan (17.0%, Due 12/03) Debt Securities (12.9%, Due 9/02 9/05) Preferred Equity Interest Options	2,755 17,832 14,067 1,639	2,755 17,832 19,060 1,639
Gordian Group, Inc. (Business Services)	Loan (15.0%, Due 6/07 3/09) Common Stock (1,000 shares)	11,126 2,885	11,126 3,800
HealthASPex, Inc. (Business Services)	Preferred Stock (1,000,000 shares) Preferred Stock (1,451,380 shares) Common Stock (1,451,380 shares)	700 4,900 4	700 2,171
HMT, Inc. (Energy Services)	Debt Securities (13.3%, Due 12/08) Preferred Stock (554,052 shares) Common Stock (300,000 shares) Warrants	9,247 2,488 3,000 1,155	9,247 2,488 4,625 1,781
Housecall Medical Resources, Inc. (Healthcare Services)	Loan (16.7%, Due 11/07 11/09) Common Stock (864,000 shares)	15,425 86	15,425 31,000
Impact Innovations Group, LLC (Business Services)	Equity Interests in Affiliate (See Note 3) Warrants	14,756 1,674	21,585
Jakel, Inc. (Industrial Products)	Loan (15.5%, Due 3/08) Debt Securities (15.5%, Due 3/08) Preferred Stock (6,460 shares) Common Stock (158,061 shares) Standby Letter of Credit (\$1,222)	3,840 8,083 6,460 9,347	3,840 8,083 2,913
Legacy Partners Group, LLC (Financial Services)	Loan (14.0%, Due 5/09) Debt Securities (18.0%, Due 5/09) Equity Interests	2,500 1,800 2,286	2,500 1,800 2,286
Litterer Beteiligungs-GmbH <sup>(4)</sup> (Business Services)	Debt Securities (5.0%, Due 3/07) Equity Interest	1,424 835	1,410

## Edgar Filing: - Form

Mercury Air Centers, Inc. (Business Services)	Loan (13.8%, Due 4/09) Common Stock (50,000 shares)	53,201 29,516	53,201 29,516
--------------------------------------------------	--------------------------------------------------------	------------------	------------------

---

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

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

(3) Public company.

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

(5) Non-registered investment company.

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

F-7

---

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

(Information at June 30, 2004, is unaudited)

Private Finance Portfolio Company (in thousands, except number of shares)	Investment <sup>(1)(2)</sup>	June 30, 2004	
		Cost	Value
			(unaudited)
MVL Group, Inc. (Business Services)	Loan (12.2%, Due 10/07 7/09) Debt Securities (14.4%, Due 7/09) Common Stock (648,661 shares)	\$ 17,705 17,268 643	\$ 17,705 17,268 3,900
Powell Plant Farms, Inc. (Consumer Products)	Loan (15.0%, Due 1/05) Debt Securities (20.0%, Due 6/03) Preferred Stock (1,483 shares) Warrants	21,917 19,224	21,917 10,709
Redox Brands, Inc. (Consumer Products)	Loan (19.0%, Due 12/07) Debt Securities (16.0%, Due 3/08) Preferred Stock (2,726,444 shares) Warrants Guaranty (\$125)	3,225 10,454 7,903 584	3,225 10,454 11,196 475
Staffing Partners Holding Company, Inc. (Business Services)	Debt Securities (14.5%, Due 10/05) Preferred Stock (439,600 shares) Common Stock (69,773 shares) Warrants	6,084 4,968 50 10	6,084 2,765
Startec Global Communications Corporation (Telecommunications)	Loan (10.0%, Due 5/07 5/09) Common Stock (19,180,000 shares)	14,722 37,255	14,722 11,548
STS Operating, Inc. (Industrial Products)	Preferred Stock (5,769,424 shares) Common Stock (3,000,000 shares) Options	6,818 3,177	6,818 3,700
Total companies more than 25% owned		\$ 1,103,189	\$ 1,063,677
<b>Companies 5% to 25% Owned</b>			
Aspen Pet Products, Inc. (Consumer Products)	Loans (19.0%, Due 6/08) Preferred Stock (2,602 shares) Common Stock (1,400 shares) Warrants	\$ 18,221 2,154 140	\$ 18,221 1,416
Border Foods, Inc. (Consumer Products)	Loan (13.0%, Due 12/10) Debt Securities (13.0%, Due 12/10) Preferred Stock (50,919 shares) Common Stock (1,810 shares) Warrants	3,000 9,481 2,000 45 665	3,000 9,481 2,000 45 665
The Debt Exchange Inc.	Preferred Stock (921,875 shares)	1,250	1,369

## Edgar Filing: - Form

(Business Services)

---

- (1) Interest rates represent the weighted average annual stated interest rate on loans and debt securities, which are presented by nature of indebtedness for a single issuer. The maturity dates represent the earliest and the latest maturity dates.
- (2) Common stock, preferred stock, warrants, options, and equity interests are generally non-income producing and restricted.
- (3) Public company.
- (4) Non-U.S. company or principal place of business outside the U.S.
- (5) Non-registered investment company.

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

F-8

---

**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)**

(Information at June 30, 2004, is unaudited)

Private Finance Portfolio Company (in thousands, except number of shares)	Investment <sup>(1)(2)</sup>	June 30, 2004	
		Cost	(unaudited) Value
EDM Consulting, LLC (Business Services)	Debt Securities (8.0%, Due 1/05) Equity Interests	\$ 1,800 250	\$ 200
GFC Holdings, LLC (Business Services)	Warrants	800	900
Liberty-Pittsburgh Systems, Inc. (Business Services)	Debt Securities (17.0%, Due 4/06) Common Stock (123,929 shares)	3,972 142	1,326
MasterPlan, Inc. (Business Services)	Loan (12.0%, Due on demand) Common Stock (1,350 shares)	959 42	1,204 235
MortgageRamp, Inc. (Business Services)	Common Stock (772,000 shares)	3,860	1,320
Nexcel Synthetics, LLC (Consumer Products)	Loan (14.5%, Due 6/09) Equity Interests	10,027 1,690	10,027 1,541
Nobel Learning Communities, Inc. <sup>(3)</sup> (Education)	Preferred Stock (1,214,356 shares) Warrants	2,764 575	2,764
Packaging Advantage Corporation (Business Services)	Debt Securities (18.5%, Due 4/08) Common Stock (232,168 shares) Warrants	14,731 2,386 963	14,365
Pres Air Trol LLC (Industrial Products)	Loan (12.0%, Due 4/10) Debt Securities (12.0%, Due 4/10) Equity Interests	49 6,253 1,323	49 6,253 1,323
Professional Paint, Inc. (Consumer Products)	Loan (18.3%, Due 8/08) Debt Securities (18.3%, Due 8/08) Preferred Stock (15,000 shares) Common Stock (110,000 shares)	5,135 25,025 23,596 69	5,135 25,025 23,596 8,800
Progressive International Corporation (Consumer Products)	Loan (16.0%, Due 12/09) Preferred Stock (500 shares) Common Stock (197 shares) Warrants	7,173 500 13	7,173 784 480
Total Foam, Inc. (Industrial Products)	Debt Securities (12.0%, Due 6/96 1/99) Common Stock (164 shares)	142 10	73

## Edgar Filing: - Form

- (1) Interest rates represent the weighted average annual stated interest rate on loans and debt securities, which are presented by nature of indebtedness for a single issuer. The maturity dates represent the earliest and the latest maturity dates.
- (2) Common stock, preferred stock, warrants, options, and equity interests are generally non-income producing and restricted.
- (3) Public company.
- (4) Non-U.S. company or principal place of business outside the U.S.
- (5) Non-registered investment company.

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

F-9

---

**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)**

(Information at June 30, 2004, is unaudited)

Private Finance Portfolio Company (in thousands, except number of shares)	Investment <sup>(1)(2)</sup>	June 30, 2004	
		Cost	Value
Universal Environmental Services, LLC (Business Services)	Loan (13.5%, Due 2/09)	\$ 12,093	\$ 12,093
	Equity Interests	1,500	1,500
Total companies 5% to 25% owned		\$ 164,798	\$ 162,363
<b>Companies Less Than 5% Owned</b>			
Alderwoods Group, Inc. <sup>(3)</sup> (Consumer Services)	Common Stock (357,568 shares)	\$ 5,006	\$ 4,362
American Barbecue & Grill, Inc. (Retail)	Warrants	125	
Apogen Technologies, Inc. (Business Services)	Debt Securities (13.0%, Due 1/10)	4,980	4,980
	Preferred Stock (270,008 shares)	2,700	2,700
	Common Stock (1,256,452 shares)	50	1,747
	Warrants		3
Aviation Technologies, Inc. (Industrial Products)	Loan (17.0%, Due 5/11)	20,627	20,627
Benchmark Medical, Inc. (Healthcare Services)	Debt Securities (14.0%, Due 12/08)	13,579	13,579
	Warrants	18	18
Camden Partners Strategic Fund II, L.P. <sup>(5)</sup> (Private Equity Fund)	Limited Partnership Interest	2,463	2,606
Catterton Partners V, L.P. <sup>(5)</sup> (Private Equity Fund)	Limited Partnership Interest	684	549
Colibri Holding Corporation (Consumer Products)	Debt Securities (12.5%, Due 9/08)	3,506	3,506
	Preferred Stock (459 shares)	523	695
	Common Stock (3,362 shares)	1,250	812
	Warrants	290	188
Community Education Centers, Inc. (Education Services)	Loan (15.0%, Due 12/10)	15,198	15,198
Component Hardware Group, Inc. (Industrial Products)	Preferred Stock (18,000 shares)	2,503	2,503
	Common Stock (2,000 shares)	200	600



## Edgar Filing: - Form

- (1) Interest rates represent the weighted average annual stated interest rate on loans and debt securities, which are presented by nature of indebtedness for a single issuer. The maturity dates represent the earliest and the latest maturity dates.
- (2) Common stock, preferred stock, warrants, options, and equity interests are generally non-income producing and restricted.
- (3) Public company.
- (4) Non-U.S. company or principal place of business outside the U.S.
- (5) Non-registered investment company.

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

F-10

---

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

(Information at June 30, 2004, is unaudited)

Private Finance Portfolio Company (in thousands, except number of shares)	Investment <sup>(1)(2)</sup>	June 30, 2004	
		Cost	Value
Cooper Natural Resources, Inc. (Industrial Products)	Loan (20.0%, Due 6/04)	\$ 120	\$ 120
	Debt Securities (1.5%, Due 7/04)	2,000	2,000
	Preferred Stock (6,316 shares)	1,427	
	Warrants	832	
Coverall North America, Inc. (Business Services)	Loan (20.0%, Due 7/08)	15,309	15,309
	Debt Securities (20.0%, Due 7/08)	7,914	7,914
CTT Holdings (Consumer Products)	Loan (0%, Due 3/10)	1,125	1,125
DCS Business Services, Inc. (Business Services)	Debt (15.8%, Due 7/10)	21,132	21,132
	Preferred Stock (478,816 shares)	1,239	2,070
Drilltec Patents & Technologies Company, Inc. (Energy Services)	Loan (10.0%, Due 8/06)	10,918	
	Debt Securities (13.8%, Due 8/06)	1,500	
eCentury Capital Partners, L.P. <sup>(5)</sup> (Private Equity Fund)	Limited Partnership Interest	4,375	248
Elexis Beta GmbH <sup>(4)</sup> (Industrial Products)	Options	426	245
E-Talk Corporation (Business Services)	Preferred Stock (133 shares)	10,009	
	Common Stock (8,656 shares)		
Fairchild Industrial Products Company (Industrial Products)	Loan (5.8%, Due 1/03)	7,145	7,145
	Debt Securities (13.0%, Due 10/03)	5,954	2,944
	Warrants	280	
Frozen Specialties, Inc. (Consumer Products)	Debt Securities (16.0%, Due 5/08)	10,435	10,435
	Warrants	435	470
Galaxy American Communications, LLC (Broadcasting & Cable)	Loan (10.0%, Due 8/04)	995	995
	Debt Securities (16.0%, Due 10/04 10/08)		
	Common Stock (100 shares)	49,702	6,794
	Guaranty (\$800)	1,350	
	Standby Letter of Credit (\$200)		
Garden Ridge Corporation (Retail)	Debt Securities (12.9%, Due 12/05 12/07)	27,271	18,300
	Preferred Stock (1,130 shares)	1,130	

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

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

(3) Public company.

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

(5) Non-registered investment company.

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

**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)**

(Information at June 30, 2004, is unaudited)

Private Finance Portfolio Company (in thousands, except number of shares)	Investment <sup>(1)(2)</sup>	June 30, 2004	
		Cost	Value
Geotrace Technologies, Inc. (Energy Services)	Debt Securities (12.0%, Due 6/09) Warrants	\$ 16,132 2,350	\$ 16,132 2,350
Ginsey Industries, Inc. (Consumer Products)	Loans (12.5%, Due 3/06) Convertible Debentures (12.5%, Due 3/06) Warrants	4,880 500	4,880 684 1,966
Grant Broadcasting Systems II (Broadcasting & Cable)	Warrants	87	2,750
Griffith Energy, Inc. (Energy Services)	Loan (16.3%, Due 3/11)	16,742	16,742
Grotech Partners, VI, L.P. <sup>(5)</sup> (Private Equity Fund)	Limited Partnership Interest	4,013	2,602
Haven Eldercare of New England, LLC (Healthcare Services)	Loans (9.3%, Due 10/05)	46,665	47,076
HealthMarket, Inc. (Health Insurance)	Debt Securities (12.0%, Due 3/08) Warrants	9,997 439	9,997 439
The Hillman Companies, Inc. <sup>(3)</sup> (Consumer Products)	Loan (13.5%, Due 9/11)	42,311	42,311
Homax Holdings, Inc. (Consumer Products)	Debt (12.0%, Due 8/10) Warrants	10,055 927	10,055 927
Icon International, Inc. (Business Services)	Common Stock (25,707 shares)	76	
Interline Brands, Inc. (Business Services)	Preferred Stock (199,313 shares) Common Stock (15,615 shares) Warrants	1,849 139 1,181	3,194
International Fiber Corporation (Industrial Products)	Debt Securities (14.0%, Due 6/12) Preferred Stock (25,000 shares)	20,895 2,500	20,895 2,500
JRI Industries, Inc. (Industrial Products)	Debt Securities (14.5%, Due 12/04) Warrants	1,565 74	1,565 39
Kirker Enterprises, Inc. (Industrial Products)	Equity Interest Warrants	4 348	4 1,096

## Edgar Filing: - Form

---

Love Funding Corporation (Financial Services)	Preferred Stock (26,000 shares)	359	359
--------------------------------------------------	---------------------------------	-----	-----

---

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

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

(3) Public company.

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

(5) Non-registered investment company.

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

F-12

---

**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)**

(Information at June 30, 2004, is unaudited)

Private Finance Portfolio Company (in thousands, except number of shares)	Investment <sup>(1)(2)</sup>	June 30, 2004	
		Cost (unaudited)	Value
Matrics, Inc. (Industrial Products)	Preferred Stock (511,876 shares) Warrants	\$ 500	\$ 771
MedAssets, Inc. (Business Services)	Preferred Stock (227,865 shares) Warrants	2,049 136	2,648
Mercury Air Group, Inc. <sup>(3)</sup> (Business Services)	Warrants	427	
Mid-Atlantic Venture Fund IV, L.P. <sup>(5)</sup> (Private Equity Fund)	Limited Partnership Interest	5,850	3,057
Midview Associates, L.P. (Housing)	Warrants		
Mogas Energy, LLC (Energy Services)	Debt Securities (9.5%, Due 3/12 4/12) Warrants	16,118 1,774	16,118 2,300
Norstan Apparel Shops, Inc. (Retail)	Debt Securities (15.6%, Due 12/07 9/08) Common Stock (29,663 shares) Warrants	12,960 4,750 655	11,647
Novak Biddle Venture Partners III, L.P. <sup>(5)</sup> (Private Equity Fund)	Limited Partnership Interest	1,590	1,286
Nursefinders, Inc. (Healthcare Services)	Loan (13.0%, Due 1/08) Debt Securities (12.0%, Due 1/08) Warrants	48 11,389 900	48 11,389 611
Oahu Waste Services, Inc. (Business Services)	Debt Securities (12.0%, Due 9/08) Stock Appreciation Rights	8,776 239	8,776 445
Onyx Television GmbH <sup>(4)</sup> (Broadcasting & Cable)	Preferred Units	201	
Opinion Research Corporation <sup>(3)</sup> (Business Services)	Loan (13.0%, Due 11/07 5/09) Warrants	21,894 996	21,894 595
Oriental Trading Company, Inc. (Consumer Products)	Common Stock (13,820 shares)	10	3,412
Polaris Pool Systems, Inc.	Debt Securities (12.0%, Due 9/07)	11,170	11,170

Edgar Filing: - Form

(Consumer Products)

Warrants

1,145

1,700

---

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

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

(3) Public company.

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

(5) Non-registered investment company.

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

F-13

---

**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)**

(Information at June 30, 2004, is unaudited)

Private Finance Portfolio Company (in thousands, except number of shares)	Investment <sup>(1)(2)</sup>	June 30, 2004	
		Cost (unaudited)	Value
Prosperco Finanz Holding AG <sup>(4)</sup> (Financial Services)	Convertible Debentures (11.7%, Due 7/03 8/08)	\$ 8,131	\$ 50
	Common Stock (1,528 shares)	1,059	
	Warrants		
RadioVisa Corporation (Broadcasting & Cable)	Loan (15.5%, Due 12/08)	25,191	25,191
Resun Leasing, Inc. (Business Services)	Loan (15.5%, Due 11/07)	30,000	30,000
S.B. Restaurant Company (Retail)	Debt Securities (15.0%, Due 11/08)	9,491	9,491
	Preferred Stock (54,125 shares)	135	135
	Warrants	619	619
SBBUT, LLC (Consumer Products)	Equity Interests	421	421
	Warrants	54	54
Soff-Cut Holdings, Inc. (Industrial Products)	Debt Securities (20.0%, Due 6/07)	10,440	10,440
	Preferred Stock (300 shares)	300	294
	Common Stock (2,000 shares)	200	
SPP Mezzanine Fund, L.P. <sup>(5)</sup> (Private Equity Fund)	Limited Partnership Interest	725	618
SunStates Refrigerated Services, Inc. (Warehouse Facilities)	Loans (8.7%, Due 9/97 1/05)	4,466	1,500
	Debt Securities (10.0%, Due 1/03)	2,445	
Sydran Food Services II, L.P. (Retail)	Debt Securities (25.0%, Due 12/08)	12,973	50
	Equity Interests	3,747	
	Warrants	162	
United Pet Group, Inc. (Consumer Products)	Debt Securities (12.0%, Due 7/07 2/10)	9,260	9,260
	Warrants	85	3,100
United Site Services, Inc. (Business Services)	Loan (16.0%, Due 12/10)	26,646	26,646
Updata Venture Partners II, L.P. <sup>(5)</sup> (Private Equity Fund)	Limited Partnership Interest	3,375	3,202
U.S. Security Holdings, Inc.	Warrants	826	2,000



- (1) Interest rates represent the weighted average annual stated interest rate on loans and debt securities, which are presented by nature of indebtedness for a single issuer. The maturity dates represent the earliest and the latest maturity dates.
- (2) Common stock, preferred stock, warrants, options, and equity interests are generally non-income producing and restricted.
- (3) Public company.
- (4) Non-U.S. company or principal place of business outside the U.S.
- (5) Non-registered investment company.

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

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

(Information at June 30, 2004, is unaudited)

Private Finance Portfolio Company (in thousands, except number of shares)	Investment <sup>(1)(2)</sup>	June 30, 2004	
		Cost (unaudited)	Value
Venturehouse-Cibernet Investors, LLC (Business Services)	Equity Interest	\$ 34	\$ 34
Venturehouse Group, LLC <sup>(5)</sup> (Private Equity Fund)	Equity Interest	1,000	402
VICORP Restaurants, Inc. (Retail)	Warrants	33	191
Walker Investment Fund II, LLLP <sup>(4)</sup> (Private Equity Fund)	Limited Partnership Interest	1,330	374
Wear Me Apparel Corporation (Consumer Products)	Debt Securities (15.0%, Due 12/10) Warrants	48,725 1,219	48,725 1,219
Weston Solutions, Inc. (Business Services)	Loan (17.3%, Due 6/10)	7,319	7,319
Wilshire Restaurant Group, Inc. (Retail)	Debt Securities (18.0%, Due 6/07) Warrants	17,221 735	17,115
Wilton Industries, Inc. (Consumer Products)	Loan (19.3%, Due 6/08)	9,600	9,600
Woodstream Corporation (Consumer Products)	Loan (14.0%, Due 11/10) Debt Securities (14.0%, Due 11/10) Common Stock (180 shares) Warrants	253 16,723 1,800 587	253 16,723 2,300 751
Total companies less than 5% owned		\$ 802,333	\$ 686,426
Total private finance (116 portfolio companies)		\$2,070,320	\$1,912,466

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

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

(3) Public company.

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

(5) Non-registered investment company.

Edgar Filing: - Form

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

F-15

---

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)

(Information at June 30, 2004, is unaudited)

	Stated Interest	Face	June 30, 2004	
			Cost (unaudited)	Value
<b>Commercial Real Estate Finance</b>				
<b>(in thousands)</b>				
<b>Commercial Mortgage-Backed Securities</b>				
Mortgage Capital Funding, Series 1998-MC3	5.5%	\$ 53,100	\$ 35,025	\$ 29,010
Morgan Stanley Capital I, Series 1999-RM1	6.4%	28,865	9,872	9,872
COMM 1999-1	5.7%	56,477	27,817	26,348
Morgan Stanley Capital I, Series 1999-FNV1	6.1%	31,786	18,585	14,081
DLJ Commercial Mortgage Trust 1999-CG2	6.1%	43,131	14,096	13,508
Commercial Mortgage Acceptance Corp., Series 1999-C1	6.8%	18,643	5,002	5,002
LB Commercial Mortgage Trust, Series 1999-C2	6.7%	11,603	1,677	1,748
Chase Commercial Mortgage Securities Corp., Series 1999-2	6.5%	20,950	5,460	5,455
FUNB CMT, Series 1999-C4	6.5%	21,125	7,980	7,067
Heller Financial, HFCMC Series 2000 PH-1	6.6%	24,040	9,191	8,658
SBMS VII, Inc., Series 2000-NL1	7.2%	8,289	4,616	4,047
DLJ Commercial Mortgage Trust, Series 2000-CF1	7.0%	26,708	11,160	11,136
Deutsche Bank Alex. Brown, Series Comm 2000-C1	6.9%	18,068	4,286	2,935
LB-UBS Commercial Mortgage Trust, Series 2000-C4	6.9%	16,665	3,612	4,424
Credit Suisse First Boston Mortgage Securities Corp., Series 2001-CK1	5.9%	17,502	4,567	5,308
JP Morgan-CIBC-Deutsche 2001	5.8%	25,398	7,274	7,258
Lehman Brothers-UBS Warburg 2001-C2	6.4%	23,426	6,802	9,057
SBMS VII, Inc., Series 2001-C1	6.1%	20,333	4,392	2,182
GE Capital Commercial Mortgage Securities Corp., Series 2001-2	6.1%	21,799	7,018	7,005
Credit Suisse First Boston Mortgage Securities Corp., Series 2001-CKN5	5.2%	22,292	6,865	6,790
JP Morgan Chase Commercial Mortgage Securities Corp., Series 2001-C1	5.6%	25,050	6,110	6,097
SBMS VII, Inc., Series 2001-C2	6.2%	23,217	7,152	7,082
FUNB CMT, Series 2002-C1	6.0%	22,097	9,058	8,036
GE Capital Commercial Mortgage Corp., Series 2002-1	6.2%	40,325	17,501	19,116
GMAC Commercial Mortgage Securities, Inc., Series 2002-C2	5.8%	27,926	10,927	11,177
GE Capital Commercial Mortgage Corp., Series 2002-3	5.1%	38,047	13,362	13,539
Morgan Stanley Dean Witter Capital I Trust 2002-IQ3	6.0%	15,919	3,790	3,790
LB-UBS Commercial Mortgage Trust 2003-C1	4.6%	37,896	12,359	12,370
GS Mortgage Securities Corporation II Series 2003-C1	4.7%	26,189	9,190	9,190
J.P. Morgan Chase Commercial Mortgage Securities Corp., Series 2003-ML1	4.9%	2,947	2,313	2,336
Credit Suisse First Boston Mortgage Securities Corp., Series 2003-CK2	4.9%	56,680	28,378	28,699
COMM 2003-LNB1	4.4%	24,324	5,750	5,750
Wachovia Bank Commercial Mortgage Trust, Series 2003-C5	4.3%	48,202	17,731	17,575
GE Commercial Mortgage Corporation, Series 2003-C1	5.1%	9,389	7,563	7,781
GMAC Commercial Mortgage Securities, Inc., Series 2003-C2	5.5%	56,441	25,245	25,832
GMAC Commercial Mortgage Securities, Inc., Series 2003-C3	5.3%	6,535	5,461	5,576
LB-UBS Commercial Mortgage Trust 2003-C8	5.4%	12,999	10,413	10,759
Wachovia Bank Commercial Mortgage Trust, Series 2003-C9	5.3%	46,793	22,621	22,727
COMM 2004-LNB2	5.0%	4,770	3,490	3,426

Edgar Filing: - Form

GE Commercial Mortgage Corporation, Series 2004-C1	5.0%	48,049	21,891	21,806
LB-UBS Commercial Mortgage Trust 2004-C1	4.9%	35,400	14,839	14,793
MezzCapp Commercial Mortgage Trust, Series 2004-C1	10.0%	1,990	821	821
Wachovia Bank Commercial Mortgage Trust, Series 2004-C10	5.0%	7,110	5,307	5,302
COMM 2004-LNB3	5.3%	46,785	25,265	25,375
GE Commercial Mortgage Corporation, Series 2004-C2	5.3%	14,287	12,249	11,929
GMAC Commercial Mortgage Securities, Inc. Series 2004-C1	5.3%	40,671	25,495	24,921
GS Mortgage Securities Corporation II, Series 2004-C1	4.6%	39,613	24,324	24,100
Total commercial mortgage-backed securities (47 issuances)		\$ 1,269,851	\$ 543,902	\$ 530,796

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

**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF INVESTMENTS (Continued)**

(Information at June 30, 2004, is unaudited)

	June 30, 2004	
	Cost	Value
<b>Commercial Real Estate Finance</b>		
<b>(in thousands, except number of loans)</b>		
<b>Collateralized Debt Obligations</b>		
Crest 2001-1, Ltd. <sup>(4)</sup>	\$ 22,409	\$ 22,409
Crest 2002-1, Ltd. <sup>(4)</sup>	24,026	24,026
Crest 2002-IG, Ltd. <sup>(4)</sup>	4,332	4,332
Crest Clarendon Street 2002-1, Ltd. <sup>(4)</sup>	940	940
Crest 2003-1, Ltd. <sup>(4)</sup>	92,330	92,330
Crest 2003-2, Ltd. <sup>(4)</sup>	26,052	26,052
TIAA Real Estate CDO 2003-1, Ltd. <sup>(4)</sup>	1,826	1,852
Crest Exeter Street Solar 2004-1, Ltd. <sup>(4)</sup>	3,730	3,667
Total collateralized debt obligations	\$ 175,645	\$ 175,608

	Interest Rate Ranges	Number of Loans			
<b>Commercial Mortgage Loans</b>					
	Up to 6.99%	16	\$	13,799	\$ 14,190
	7.00% 8.99%	36		84,505	84,505
	9.00% 10.99%	8		33,047	32,845
	11.00% 12.99%	6		10,941	8,933
	13.00% 14.99%	2		4,158	2,546
	15.00% and above	1		3,932	3,932
Total commercial mortgage loans		69	\$	150,382	\$ 146,951
<b>Real Estate Owned</b>				16,074	14,444
<b>Equity Interests</b> (Guarantees \$2,731)				5,751	4,549
Total commercial real estate finance			\$	891,754	\$ 872,348
Total portfolio			\$	2,962,074	\$ 2,784,814

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

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

## Edgar Filing: - Form

- (3) Public company.
- (4) Non-U.S. company or principal place of business outside the U.S.
- (5) Non-registered investment company.

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

F-17

---

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF INVESTMENTS

Private Finance Portfolio Company (in thousands, except number of shares)	Investment <sup>(1)(2)</sup>	December 31, 2003	
		Cost	Value
<b>Companies More Than 25% Owned</b>			
ACE Products, Inc. (Industrial Products)	Loan (20.5%, Due 7/09) Common Stock (5,000 shares)	\$ 17,164	\$ 50
Acme Paging, L.P. <sup>(4)</sup> (Telecommunications)	Loan (6.7%, Due 12/07-1/08) Equity Interests Common Stock (3,083 shares)	4,496 13,274 27	4,496 2,586
Alaris Consulting, LLC (Business Services)	Loan (17.3%, Due 12/05-12/07) Equity Interests Guaranty (\$1,100)	19,478 5,165	8,160
American Healthcare Services, Inc. (Healthcare Services)	Loan (0%, Due 12/05) Debt Securities (28.5%, Due 5/06) Common Stock (7,956,704 shares) Guaranty (\$1,238)	23,501 17,311 1,000	23,501 8,684
Avborne, Inc. (Business Services)	Loan (25.0%, Due 8/07) Preferred Stock (12,500 shares) Common Stock (27,500 shares) Standby Letter of Credit (\$6,978)	2,863 14,138	2,863 2,300
Business Loan Express, LLC (Financial Services)	Debt Securities (25.0%, Due 12/05) Class A Equity Interests Class B Equity Interests Class C Equity Interests Guaranty (\$78,245 See Note 3) Standby Letters of Credit (\$35,550 See Note 3)	40,044 47,800 57,911 109,340	40,044 47,800 99,386 154,960
Callidus Capital Corporation (Financial Services)	Debt Securities (18.0%, Due 10/08) Common Stock (10 shares)	3,500 1,768	3,500 1,768
The Color Factory, Inc. (Consumer Products)	Loan (12.0%, Due 6/06) Preferred Stock (1,000 shares) Common Stock (980 shares)	15,377 1,002 6,535	6,952
Foresite Towers, LLC (Tower Leasing)	Equity Interests	18,549	17,638
Global Communications, LLC (Business Services)	Loan (17.0%, Due 12/03) Debt Securities (12.9%, Due 9/02-9/05) Preferred Equity Interest Options	2,350 17,247 14,067 1,639	2,350 17,247 18,351 1,639
Gordian Group, Inc.	Loan (25.0%, Due 6/07-6/08)	9,382	9,382



## Edgar Filing: - Form

(Business Services)	Common Stock (1,000 shares)	2,385	4,000
---------------------	-----------------------------	-------	-------

---

- (1) Interest rates represent the weighted average annual stated interest rate on loans and debt securities, which are presented by nature of indebtedness for a single issuer. The maturity dates represent the earliest and the latest maturity dates.
- (2) Common stock, preferred stock, warrants, options, and equity interests are generally non-income producing and restricted.
- (3) Public company.
- (4) Non-U.S. company or principal place of business outside the U.S.
- (5) Non-registered investment company.

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

F-18

---

Edgar Filing: - Form

Private Finance Portfolio Company (in thousands, except number of shares)	Investment <sup>(1)(2)</sup>	December 31, 2003	
		Cost	Value
HealthASPex, Inc. (Business Services)	Preferred Stock (1,000,000 shares)	\$ 700	\$ 700
	Preferred Stock (1,451,380 shares)	4,900	2,650
	Common Stock (1,451,380 shares)	4	
The Hillman Companies, Inc. <sup>(3)</sup> (Consumer Products)	Debt Securities (18.0%, Due 9/09)	43,965	43,965
	Common Stock (6,890,937 shares)	50,697	190,577
HMT, Inc. (Energy Services)	Debt Securities (13.3%, Due 12/08)	9,186	9,186
	Preferred Stock (554,052 shares)	2,303	2,303
	Common Stock (300,000 shares)	3,000	4,264
	Warrants	1,155	1,641
Housecall Medical Resources, Inc. (Healthcare Services)	Loan (16.7%, Due 11/07 11/09)	15,242	15,242
	Preferred Stock (3,890,344 shares)	3,889	3,889
	Common Stock (864,000 shares)	86	23,000
Jakel, Inc. (Industrial Products)	Loan (15.5%, Due 3/08)	2,062	2,062
	Debt Securities (15.5%, Due 3/08)	7,770	7,770
	Preferred Stock (6,460 shares)	6,460	4,069
	Common Stock (158,061 shares)	9,347	
	Standby Letter of Credit (\$2,952)		
Litterer Beteiligungs-GmbH <sup>(4)</sup> (Business Services)	Debt Securities(5.0%, Due 3/07)	1,430	1,379
	Equity Interest	835	
MVL Group, Inc. (Business Services)	Loan (12.1%, Due 10/07 7/09)	19,075	19,075
	Debt Securities (14.5%, Due 7/09)	16,787	16,787
	Common Stock (648,661 shares)	643	643
Powell Plant Farms, Inc. (Consumer Products)	Loan (15.0%, Due 1/05)	21,542	21,542
	Debt Securities (20.0%, Due 6/03)	19,224	11,692
	Preferred Stock (1,483 shares)		
	Warrants		
Redox Brands, Inc. (Consumer Products)	Loan (19.0%, Due 12/07)	3,127	3,127
	Debt Securities (16.0%, Due 3/08)	10,243	10,243
	Preferred Stock (2,404,086 shares)	6,965	6,965
	Warrants	584	584
	Guaranty (\$125)		
Staffing Partners Holding Company, Inc. (Business Services)	Debt Securities (14.5%, Due 10/05)	5,794	5,794
	Preferred Stock (414,600 shares)	4,968	2,018
	Common Stock (50,200 shares)	50	
	Warrants	10	
STS Operating, Inc. (Industrial Products)	Preferred Stock (5,769,424 shares)	6,473	6,473
	Common Stock (3,000,000 shares)	3,177	3,700
	Options		
Sure-Tel, Inc. (Consumer Services)	Preferred Stock (1,000,000 shares)	1,000	1,000
	Common Stock (37,000 shares)	5,018	320

- (1) Interest rates represent the weighted average annual stated interest rate on loans and debt securities, which are presented by nature of indebtedness for a single issuer. The maturity dates represent the earliest and the latest maturity dates.
- (2) Common stock, preferred stock, warrants, options, and equity interests are generally non-income producing and restricted.
- (3) Public company.
- (4) Non-U.S. company or principal place of business outside the U.S.
- (5) Non-registered investment company.

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

F-19

---

Edgar Filing: - Form

Private Finance Portfolio Company (in thousands, except number of shares)	Investment <sup>(1)(2)</sup>	December 31, 2003	
		Cost	Value
Total companies more than 25% owned		\$ 755,024	\$ 900,317
<b>Companies 5% to 25% Owned</b>			
Aspen Pet Products, Inc. (Consumer Products)	Loans (19.0%, Due 6/08) Preferred Stock (2,206 shares) Common Stock (1,400 shares) Warrants	\$ 17,675 2,075 140	\$ 17,675 845
Border Foods, Inc. (Consumer Products)	Loan (13.0%, Due 12/10) Debt Securities (13.0%, Due 12/10) Preferred Stock (50,919 shares) Common Stock (1,810 shares) Warrants	3,000 9,454 2,000 45 665	3,000 9,454 2,000 71 1,059
CBA-Mezzanine Capital Finance, LLC (Financial Services)	Loan (19.0%, Due 4/05)	14,310	16,185
CorrFlex Graphics, LLC (Business Services)	Debt Securities (18.5%, Due 12/07) Warrants Options	12,699	12,699 18,411 1,589
The Debt Exchange Inc. (Business Services)	Preferred Stock (921,875 shares)	1,250	1,250
EDM Consulting, LLC (Business Services)	Debt Securities (8.0%, Due 1/05) Equity Interests	1,802 250	218
International Fiber Corporation (Industrial Products)	Debt Securities (12.7%, Due 1/08) Common Stock (1,029,069 shares) Warrants	22,828 5,483 550	22,828 6,816 684
Liberty-Pittsburgh Systems, Inc. (Business Services)	Debt Securities (17.0%, Due 11/04) Common Stock (123,929 shares)	3,384 142	2,454
MasterPlan, Inc. (Business Services)	Loan (12.0%, Due on demand) Common Stock (1,350 shares)	959 42	959 200
MortgageRamp, Inc. (Business Services)	Common Stock (772,000 shares)	3,860	2,084
Nobel Learning Communities, Inc. <sup>(3)</sup> (Education)	Debt Securities (12.0%, Due 7/07) Preferred Stock (1,214,356 shares) Warrants	9,838 2,764 575	9,838 2,764 166
Packaging Advantage Corporation (Business Services)	Debt Securities (12.0%, Due 4/08) Common Stock (232,168 shares) Warrants	14,350 2,386 963	14,350 1,069 431

## Edgar Filing: - Form

- (1) Interest rates represent the weighted average annual stated interest rate on loans and debt securities, which are presented by nature of indebtedness for a single issuer. The maturity dates represent the earliest and the latest maturity dates.
- (2) Common stock, preferred stock, warrants, options, and equity interests are generally non-income producing and restricted.
- (3) Public company.
- (4) Non-U.S. company or principal place of business outside the U.S.
- (5) Non-registered investment company.

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

F-20

---

Edgar Filing: - Form

Private Finance Portfolio Company (in thousands, except number of shares)		December 31, 2003	
		Investment <sup>(1)(2)</sup>	
		Cost	Value
Professional Paint, Inc. (Consumer Products)	Loan (18.3%, Due 8/08)	\$ 4,976	\$ 4,976
	Debt Securities (18.3%, Due 8/08)	24,258	24,258
	Preferred Stock (15,000 shares)	22,156	22,156
	Common Stock (110,000 shares)	69	5,500
Progressive International Corporation (Consumer Products)	Debt Securities (16.0%, Due 6/06-12/06)	3,977	3,977
	Preferred Stock (500 shares)	500	707
	Common Stock (197 shares)	13	668
	Warrants		
Sidasur Holdings, Inc. (Business Services)	Debt Securities (13.0%, Due 1/10)	4,978	4,978
	Preferred Stock (98,000 shares)	980	980
	Common Stock (492,941 shares)	20	896
	Warrants		5
Total Foam, Inc. (Industrial Products)	Debt Securities (12.0%, Due 6/96-1/99)	174	105
	Common Stock (164 shares)	10	
Total companies 5% to 25% owned		\$ 195,600	\$ 218,305
<b>Companies Less Than 5% Owned</b>			
Advantage Mayer, Inc. (Business Services)	Loan (15.4%, Due 12/04-12/08)	\$ 8,223	\$ 8,223
	Debt Securities (15.0%, Due 12/08)	10,649	10,649
Alderwoods Group, Inc. <sup>(3)</sup> (Consumer Services)	Common Stock (357,568 shares)	5,006	3,368
American Barbecue & Grill, Inc. (Retail)	Warrants	125	
Aviation Technologies, Inc. (Industrial Products)	Loan (17.0%, Due 5/11)	20,213	20,213
Benchmark Medical, Inc. (Healthcare Services)	Debt Securities (14.0%, Due 12/08)	13,502	13,502
	Warrants	18	38
Camden Partners Strategic Fund II, L.P. <sup>(5)</sup> (Private Equity Fund)	Limited Partnership Interest	2,919	2,958
Catterton Partners V, L.P. <sup>(5)</sup> (Private Equity Fund)	Limited Partnership Interest	685	685
Central Marketing, Inc. (Business Services)	Loan (10.0%, Due 12/11)	10,946	10,946
Colibri Holding Corporation (Consumer Products)	Debt Securities (12.5%, Due 9/08)	3,500	3,500
	Preferred Stock (237 shares)	300	416
	Common Stock (3,362 shares)	1,250	679

- (1) Interest rates represent the weighted average annual stated interest rate on loans and debt securities, which are presented by nature of indebtedness for a single issuer. The maturity dates represent the earliest and the latest maturity dates.
- (2) Common stock, preferred stock, warrants, options, and equity interests are generally non-income producing and restricted.
- (3) Public company.
- (4) Non-U.S. company or principal place of business outside the U.S.
- (5) Non-registered investment company.

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

F-21

---

Edgar Filing: - Form

Private Finance Portfolio Company (in thousands, except number of shares)	Investment <sup>(1)(2)</sup>	December 31, 2003	
		Cost	Value
Community Education Centers, Inc. (Education Services)	Loan (15.0%, Due 12/10)	\$ 14,888	\$ 14,888
Component Hardware Group, Inc. (Industrial Products)	Debt Securities (16.5%, Due 8/07) Preferred Stock (18,000 shares) Common Stock (2,000 shares)	11,809 2,406 200	11,809 2,406 750
Cooper Natural Resources, Inc. (Industrial Products)	Loan (17.0%, Due 6/04) Debt Securities (1.5%, Due 7/04) Preferred Stock (6,316 shares) Warrants	300 2,000 1,427 832	300 2,000 984
Coverall North America, Inc. (Business Services)	Loan (20.0%, Due 7/08) Debt Securities (20.0%, Due 7/08)	14,402 7,445	14,402 7,445
CTT Holdings (Consumer Products)	Loan (0%, Due 3/10)	1,250	1,250
Drilltec Patents & Technologies Company, Inc. (Energy Services)	Loan (10.0%, Due 8/06) Debt Securities (13.8%, Due 8/06)	10,918 1,500	
eCentury Capital Partners, L.P. <sup>(5)</sup> (Private Equity Fund)	Limited Partnership Interest	3,750	552
Elexis Beta GmbH <sup>(3)</sup> (Industrial Products)	Options	426	289
Eparfin S.A. <sup>(3)</sup> (Consumer Products)	Loan (6.0%, Due 12/02)	29	29
E-Talk Corporation (Business Services)	Preferred Stock (133 shares) Common Stock (8,656 shares)	10,009	
Executive Greetings, Inc. (Business Services)	Debt Securities (14.0%, Due 10/09) Warrants	18,830 360	50
Fairchild Industrial Products Company (Industrial Products)	Loan (5.8%, Due 1/03) Debt Securities (13.0%, Due 10/03) Warrants	7,166 5,954 280	7,166 3,534
Frozen Specialties, Inc. (Consumer Products)	Debt Securities (16.0%, Due 5/08) Warrants	10,240 435	10,240 435
Galaxy American Communications, LLC (Broadcasting & Cable)	Loan (10.0%, Due 8/04) Debt Securities (16.0%, Due 10/04- 10/08)	995 49,703	995 11,717
	Debt Securities (12.9%, Due 12/05- 12/07)	27,271	20,323



## Edgar Filing: - Form

Garden Ridge Corporation  
(Retail)

Preferred Stock (1,130 shares)	1,130
Common Stock (847,800 shares)	613

---

- (1) Interest rates represent the weighted average annual stated interest rate on loans and debt securities, which are presented by nature of indebtedness for a single issuer. The maturity dates represent the earliest and the latest maturity dates.
- (2) Common stock, preferred stock, warrants, options, and equity interests are generally non-income producing and restricted.
- (3) Public company.
- (4) Non-U.S. company or principal place of business outside the U.S.
- (5) Non-registered investment company.

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

F-22

---

Edgar Filing: - Form

Private Finance Portfolio Company (in thousands, except number of shares)	Investment <sup>(1)(2)</sup>	December 31, 2003	
		Cost	Value
Geotrace Technologies, Inc. (Energy Services)	Debt Securities (12.0%, Due 6/09) Warrants	\$ 15,982 2,350	\$ 15,982 2,350
Gibson Guitar Corporation (Consumer Products)	Warrants	525	1,264
Ginsey Industries, Inc. (Consumer Products)	Loans (12.5%, Due 3/06) Convertible Debentures (12.5%, Due 3/06) Warrants	5,000 500	5,000 635 1,440
Grant Broadcasting Systems II (Broadcasting & Cable)	Warrants	87	2,750
Griffith Energy, Inc. (Energy Services)	Loan (16.3%, Due 3/11)	16,419	16,419
Grotech Partners, VI, L.P. <sup>(5)</sup> (Private Equity Fund)	Limited Partnership Interest	3,599	2,241
The Hartz Mountain Corporation (Consumer Products)	Debt Securities (13.0%, Due 6/08) Common Stock (200,000 shares) Warrants	27,927 2,000 2,613	27,927 899 1,174
Haven Eldercare of New England, LLC (Healthcare Services)	Loans (9.3%, Due 10/05)	46,403	47,953
HealthMarket, Inc. (Health Insurance)	Debt Securities (12.0%, Due 3/08) Warrants	9,788 439	9,788 439
Hotelevision, Inc. (Broadcasting & Cable)	Common Stock (315 shares)	315	
Icon International, Inc. (Business Services)	Common Stock (25,707 shares)	76	
Impact Innovations Group, LLC (Business Services)	Debt Securities (15.0%, Due 12/05) Warrants	7,278 1,674	50
Insight Pharmaceuticals Corporation (Consumer Products)	Loan (16.0%, Due 9/08)	10,087	10,087
Intellirisk Management Corporation (Business Services)	Loan (12.0%, Due 4/06)	24,256	24,256
Interline Brands, Inc. (Business Services)	Preferred Stock (199,313 shares) Common Stock (15,615 shares) Warrants	1,849 139 1,181	1,849
JRI Industries, Inc. (Industrial Products)	Debt Securities (14.5%, Due 12/04) Warrants	1,554 74	1,554 39

- (1) Interest rates represent the weighted average annual stated interest rate on loans and debt securities, which are presented by nature of indebtedness for a single issuer. The maturity dates represent the earliest and the latest maturity dates.
- (2) Common stock, preferred stock, warrants, options, and equity interests are generally non-income producing and restricted.
- (3) Public company.
- (4) Non-U.S. company or principal place of business outside the U.S.
- (5) Non-registered investment company.

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

F-23

---

Edgar Filing: - Form

Private Finance Portfolio Company (in thousands, except number of shares)	Investment <sup>(1)(2)</sup>	December 31, 2003	
		Cost	Value
Julius Koch USA, Inc. (Industrial Products)	Loan (15.0%, Due 10/09)	\$ 500	\$ 500
Kirker Enterprises, Inc. (Industrial Products)	Equity Interest Warrants	4 348	4 2,896
Logic Bay Corporation (Business Services)	Common Stock (1,437,420 shares)	5,000	
Love Funding Corporation (Financial Services)	Preferred Stock (26,000 shares)	359	359
Matrics, Inc. (Industrial Products)	Preferred Stock (511,876 shares) Warrants	500	876
MedAssets, Inc. (Business Services)	Debt Securities (19.5%, Due 11/07) Preferred Stock (237,514 shares) Warrants	16,965 2,049 136	16,965 2,049
Mercury Air Group, Inc. <sup>(3)</sup> (Business Services)	Debt Securities (12.0%, Due 12/05) Warrants	23,838 427	23,838 162
Mid-Atlantic Venture Fund IV, L.P. <sup>(5)</sup> (Private Equity Fund)	Limited Partnership Interest	4,725	2,342
Midview Associates, L.P. (Housing)	Warrants		
Mogas Energy, LLC (Energy Services)	Debt Securities (9.5%, Due 3/12 4/12) Warrants	16,734 1,774	16,734 2,049
Norstan Apparel Shops, Inc. (Retail)	Debt Securities (13.6%, Due 9/08) Common Stock (29,662 shares) Warrants	11,872 4,750 655	10,339
Northeast Broadcasting Group, L.P. (Broadcasting & Cable)	Debt Securities (14.5%, Due 8/06)	213	213
Novak Biddle Venture Partners III, L.P. <sup>(5)</sup> (Private Equity Fund)	Limited Partnership Interest	1,200	914
Nursefinders, Inc. (Healthcare Services)	Debt Securities (12.0%, Due 1/08) Warrants	11,324 900	11,324 676
Oahu Waste Services, Inc. (Business Services)	Debt Securities (12.0%, Due 9/08) Stock Appreciation Rights	8,459 239	8,459 295
Onyx Television GmbH <sup>(4)</sup> (Broadcasting & Cable)	Preferred Units	201	

## Edgar Filing: - Form

Opinion Research Corporation <sup>(3)</sup> (Business Services)	Debt Securities (12.5%, Due 5/07) Warrants	14,401 996	14,401 940
--------------------------------------------------------------------	-----------------------------------------------	---------------	---------------

---

- (1) Interest rates represent the weighted average annual stated interest rate on loans and debt securities, which are presented by nature of indebtedness for a single issuer. The maturity dates represent the earliest and the latest maturity dates.
- (2) Common stock, preferred stock, warrants, options, and equity interests are generally non-income producing and restricted.
- (3) Public company.
- (4) Non-U.S. company or principal place of business outside the U.S.
- (5) Non-registered investment company.

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

F-24

---

Edgar Filing: - Form

Private Finance Portfolio Company (in thousands, except number of shares)	Investment <sup>(1)(2)</sup>	December 31, 2003	
		Cost	Value
Oriental Trading Company, Inc. (Consumer Products)	Common Stock (13,820 shares)	\$ 1,500	\$ 4,500
Polaris Pool Systems, Inc. (Consumer Products)	Debt Securities (12.0%, Due 9/07) Warrants	11,020 1,145	11,020 1,145
Prosperco Finanz Holding AG <sup>(4)</sup> (Financial Services)	Convertible Debentures (11.7%, Due 7/03-8/08) Common Stock (1,528 shares) Warrants	8,268 1,059	50
RadioVisa Corporation (Broadcasting & Cable)	Loan (15.5%, Due 12/08)	24,875	24,875
Resun Leasing, Inc. (Business Services)	Loan (15.5%, Due 11/07)	30,000	30,000
S.B. Restaurant Company (Retail)	Debt Securities (15.0%, Due 11/08) Warrants	4,369 619	4,369 619
SBBUT, LLC (Consumer Products)	Equity Interests Warrants	500 54	500 54
SmartMail, LLC (Business Services)	Loan (7.8%, Due 12/05) Debt Securities (14.0%, Due 6/08) Equity Interests Warrants	3,745 4,519 1,070 3	3,745 4,519 1,070 3
Soff-Cut Holdings, Inc. (Industrial Products)	Debt Securities (20.0%, Due 6/07) Preferred Stock (300 shares) Common Stock (2,000 shares)	10,023 300 200	10,023 294
SPP Mezzanine Fund, L.P. <sup>(5)</sup> (Private Equity Fund)	Limited Partnership Interest	198	198
Startec Global Communications Corporation <sup>(3)</sup> (Telecommunications)	Loan (12.0%, Due 12/02) Debt Securities (15.0%, Due 7/05)	25,715 20,670	22,170
SunStates Refrigerated Services, Inc. (Warehouse Facilities)	Loans (8.7%, Due 9/97-1/05) Debt Securities (10.0%, Due 1/03)	4,517 2,445	1,242
Sydran Food Services II, L.P. (Retail)	Debt Securities (25.0%, Due 12/08) Equity Interests Warrants	12,973 3,747 162	50
United Pet Group, Inc. (Consumer Products)	Debt Securities (12.0%, Due 7/07-2/10) Warrants	9,191 85	9,191 1,199

## Edgar Filing: - Form

United Site Services, Inc.  
(Business Services)

Loan (16.0%, Due 12/10)

15,183

15,183

---

- (1) Interest rates represent the weighted average annual stated interest rate on loans and debt securities, which are presented by nature of indebtedness for a single issuer. The maturity dates represent the earliest and the latest maturity dates.
- (2) Common stock, preferred stock, warrants, options, and equity interests are generally non-income producing and restricted.
- (3) Public company.
- (4) Non-U.S. company or principal place of business outside the U.S.
- (5) Non-registered investment company.

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

F-25

---

Edgar Filing: - Form

Private Finance Portfolio Company (in thousands, except number of shares)	Investment <sup>(1)(2)</sup>	December 31, 2003	
		Cost	Value
Updata Venture Partners II, L.P. <sup>(5)</sup> (Private Equity Fund)	Limited Partnership Interest	\$ 2,305	\$ 2,404
U.S. Security Holdings, Inc. (Business Services)	Debt Securities (12.2%, Due 12/09) Warrants	24,226 826	24,226 2,000
Venturehouse-Cibernet Investors, LLC (Business Services)	Equity Interest	34	34
Venturehouse Group, LLC <sup>(5)</sup> (Private Equity Fund)	Equity Interest	1,000	283
VICORP Restaurants, Inc. (Retail)	Debt Securities (16.0%, Due 12/09) Warrants	24,079 33	24,079 33
Walker Investment Fund II, LLLP <sup>(5)</sup> (Private Equity Fund)	Limited Partnership Interest	1,246	341
Wear Me Apparel Corporation (Consumer Products)	Debt Securities (15.0%, Due 12/10) Warrants	48,596 1,219	48,596 1,219
Weston Solutions, Inc. (Business Services)	Loan (17.3%, Due 6/10)	12,194	12,194
Wilshire Restaurant Group, Inc. (Retail)	Debt Securities (18.0%, Due 6/07) Warrants	17,221 735	16,532
Wilton Industries, Inc. (Consumer Products)	Loan (19.3%, Due 6/08)	9,600	9,600
Woodstream Corporation (Consumer Products)	Loan (14.0%, Due 11/10) Debt Securities (14.0%, Due 11/10) Common Stock (180 shares) Warrants	251 16,522 1,800 587	251 16,522 1,800 587
Total companies less than 5% owned		\$ 955,507	\$ 784,050
Total private finance (122 portfolio companies)		\$ 1,906,131	\$ 1,902,672

- (1) Interest rates represent the weighted average annual stated interest rate on loans and debt securities, which are presented by nature of indebtedness for a single issuer. The maturity dates represent the earliest and the latest maturity dates.
- (2) Common stock, preferred stock, warrants, options, and equity interests are generally non-income producing and restricted.
- (3) Public company.
- (4) Non-U.S. company or principal place of business outside the U.S.
- (5) Non-registered investment company.

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





	Stated Interest	Face	December 31, 2003	
			Cost	Value
<b>Commercial Real Estate Finance</b>				
<b>(in thousands)</b>				
<b>Commercial Mortgage-Backed Securities</b>				
Mortgage Capital Funding, Series 1998-MC3	5.5%	\$ 52,691	\$ 34,126	\$ 31,732
Morgan Stanley Capital I, Series 1999-RM1	6.4%	28,517	9,643	9,643
COMM 1999-1	5.7%	56,005	26,855	26,855
Morgan Stanley Capital I, Series 1999-FNV1	6.1%	24,659	14,005	10,119
DLJ Commercial Mortgage Trust 1999-CG2	6.1%	42,224	13,674	13,674
Commercial Mortgage Acceptance Corp., Series 1999-C1	6.8%	18,346	4,967	6,832
LB Commercial Mortgage Trust, Series 1999-C2	6.7%	11,603	1,733	1,766
Chase Commercial Mortgage Securities Corp., Series 1999-2	6.5%	20,545	5,314	6,606
FUNB CMT, Series 1999-C4	6.5%	20,716	7,741	7,135
Heller Financial, HFCMC Series 2000 PH-1	6.6%	23,738	8,714	8,555
SBMS VII, Inc., Series 2000-NL1	7.2%	8,139	4,505	3,884
DLJ Commercial Mortgage Trust, Series 2000-CF1	7.0%	24,019	9,524	10,516
Deutsche Bank Alex. Brown, Series Comm 2000-C1	6.9%	17,624	4,762	3,061
LB-UBS Commercial Mortgage Trust, Series 2000-C4	6.9%	16,665	3,786	5,027
Credit Suisse First Boston Mortgage Securities Corp., Series 2001-CK1	5.9%	16,758	4,072	4,072
JP Morgan-CIBC-Deutsche 2001	5.8%	24,758	6,796	6,796
Lehman Brothers-UBS Warburg 2001-C2	6.4%	23,085	6,547	6,547
SBMS VII, Inc., Series 2001-C1	6.1%	19,776	5,594	3,105
GE Capital Commercial Mortgage Securities Corp., Series 2001-2	6.1%	21,178	6,425	6,425
Credit Suisse First Boston Mortgage Securities Corp., Series 2001-CKN5	5.2%	20,347	5,214	5,214
JP Morgan Chase Commercial Mortgage Securities Corp., Series 2001-C1	5.6%	24,493	5,782	5,782
SBMS VII, Inc., Series 2001-C2	6.2%	21,619	5,820	5,820
FUNB CMT, Series 2002-C1	6.0%	25,416	10,070	7,991
GE Capital Commercial Mortgage Corp., Series 2002-1	6.2%	40,325	17,434	19,089
GMAC Commercial Mortgage Securities, Inc., Series 2002-C2	5.8%	27,926	10,855	11,109
GE Capital Commercial Mortgage Corp., Series 2002-3	5.1%	38,047	13,328	13,492
Morgan Stanley Dean Witter Capital I Trust 2002-IQ3	6.0%	15,919	3,819	3,819
LB-UBS Commercial Mortgage Trust 2003-C1	4.6%	37,896	12,272	12,267
GS Mortgage Securities Corporation II Series 2003-C1	4.7%	26,189	9,059	9,059
J.P. Morgan Chase Commercial Mortgage Securities Corp., Series 2003-ML1	4.9%	2,947	2,294	2,306
Credit Suisse First Boston Mortgage Securities Corp., Series 2003-CK2	4.9%	56,680	27,980	28,250
COMM 2003-LNB1	4.4%	24,324	5,706	5,706
Wachovia Bank Commercial Mortgage Trust, Series 2003-C5	4.3%	48,202	17,577	17,385
GE Commercial Mortgage Corporation, Series 2003-C2	5.1%	9,389	7,497	7,692
GMAC Commercial Mortgage Securities, Inc., Series 2003-C2	5.5%	59,441	27,455	28,087
GMAC Commercial Mortgage Securities, Inc., Series 2003-C3	5.3%	6,535	5,424	5,513
LB-UBS Commercial Mortgage Trust 2003-C8	5.4%	12,999	10,331	10,615
Wachovia Bank Commercial Mortgage Trust, Series 2003-C9	5.3%	46,793	22,406	22,433
<b>Total commercial mortgage-backed securities (38 issuances)</b>		<b>\$ 1,016,533</b>	<b>\$ 399,106</b>	<b>\$ 393,979</b>

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

## Edgar Filing: - Form

- (2) Common stock, preferred stock, warrants, options, and equity interests are generally non-income producing and restricted.
- (3) Public company.
- (4) Non-U.S. company or principal place of business outside the U.S.
- (5) Non-registered investment company.

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

F-27

---

	December 31, 2003	
	Cost	Value
<b>Commercial Real Estate Finance</b>		
<b>(in thousands, except number of loans)</b>		
<b>Collateralized Debt Obligations</b>		
Crest 2001-1, Ltd. <sup>(4)</sup>	\$ 22,724	\$ 22,724
Crest 2002-1, Ltd. <sup>(4)</sup>	23,614	23,614
Crest 2002-IG, Ltd. <sup>(4)</sup>	4,553	4,553
Crest Clarendon Street 2002-1, Ltd. <sup>(4)</sup>	1,005	1,005
Crest 2003-1, Ltd. <sup>(4)</sup>	107,460	107,188
Crest 2003-2, Ltd. <sup>(4)</sup>	25,542	25,542
TIAA Real Estate CDO 2003-1, Ltd. <sup>(4)</sup>	1,926	1,931
<b>Total collateralized debt obligations</b>	<b>\$ 186,824</b>	<b>\$ 186,557</b>

	Interest Rate Ranges		Number of Loans		
<b>Commercial Mortgage Loans</b>					
	Up to 6.99%		15	\$ 13,431	\$ 14,457
	7.00% 8.99%		11	22,514	21,626
	9.00% 10.99%		7	32,040	31,519
	11.00% 12.99%		8	12,166	10,191
	13.00% 14.99%		3	3,566	2,136
	15.00% and above		2	3,710	3,710
<b>Total commercial mortgage loans</b>			<b>46</b>	<b>\$ 87,427</b>	<b>\$ 83,639</b>
<b>Real Estate Owned</b>				<b>15,931</b>	<b>12,856</b>
<b>Equity Interests</b> (Guarantees \$2,731)				<b>5,641</b>	<b>4,896</b>
<b>Total commercial real estate finance</b>				<b>\$ 694,929</b>	<b>\$ 681,927</b>
<b>Total portfolio</b>				<b>\$ 2,601,060</b>	<b>\$ 2,584,599</b>

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

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

(3) Public company.

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

(5) Non-registered investment company.

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

**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Information at and for the six months ended  
June 30, 2004 and 2003, is unaudited)**

**Note 1. Organization**

Allied Capital Corporation, a Maryland corporation, is a closed-end management investment company that has elected to be regulated as a business development company ( BDC ) under the Investment Company Act of 1940 ( 1940 Act ). Allied Capital Corporation ( ACC ) has a subsidiary that has also elected to be regulated as a BDC, Allied Investment Corporation ( Allied Investment ), which is licensed under the Small Business Investment Act of 1958 as a Small Business Investment Company ( SBIC ). In addition, ACC has a real estate investment trust subsidiary, Allied Capital REIT, Inc. ( Allied REIT ), and several subsidiaries which are single member limited liability companies established primarily to hold real estate properties. ACC also has a subsidiary, A.C. Corporation ( AC Corp ), that provides diligence and structuring services on private finance and commercial real estate finance transactions, as well as structuring, transaction, management and advisory services to the Company, its portfolio companies and other third parties.

Allied Capital Corporation and its subsidiaries, collectively, are referred to as the Company.

In accordance with specific rules prescribed for investment companies, subsidiaries hold investments on behalf of the Company or provide substantial services to the Company. Portfolio investments are held for purposes of deriving investment income and future capital gains. The Company consolidates the results of its subsidiaries for financial reporting purposes. The financial results of the Company's portfolio investments are not consolidated in the Company's financial statements.

The investment objective of the Company is to achieve current income and capital gains. In order to achieve this objective, the Company invests in companies in a variety of industries, non-investment grade commercial mortgage-backed securities ( CMBS ) and collateralized debt obligation bonds and preferred shares ( CDOs ).

**Note 2. Summary of Significant Accounting Policies**

***Basis of Presentation***

The consolidated financial statements include the accounts of ACC and its subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation. Certain reclassifications have been made to the 2003, 2002 and 2001 balances to conform with the 2004 financial statement presentation.

The accompanying unaudited consolidated financial statements of the Company as of June 30, 2004, and for the six months ended June 30, 2004 and 2003, have been prepared in accordance with accounting principles generally accepted in the United States of America ( GAAP ) for interim financial information. Accordingly, they do not include all of the information and footnotes required by GAAP for complete consolidated financial statements. In the opinion of management, the unaudited consolidated financial results of the Company included herein contain all adjustments (consisting of only normal recurring accruals) necessary to present fairly the financial position of the Company as of June 30, 2004, and the results of operations, changes in net assets and cash flows for the six months

**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Information at and for the six months ended  
June 30, 2004 and 2003, is unaudited)**

**Note 2. Summary of Significant Accounting Policies, continued**

ended June 30, 2004 and 2003. The results of operations for the six months ended June 30, 2004, are not necessarily indicative of the operating results to be expected for the full year.

During 2002, the Company revised its financial statement presentation to provide additional detail for the private finance portfolio and the interest and related portfolio income and net realized gains (losses) by presenting these balances in the three categories described below. The 2001 financial statements have been revised to conform to the 2003 and 2002 presentation.

The private finance portfolio and the interest and related portfolio income and net realized gains (losses) on the private finance portfolio are presented in three categories: companies more than 25% owned, which represent portfolio companies where the Company directly or indirectly owns more than 25% of the outstanding voting securities of such portfolio company and, therefore, are deemed controlled by the Company under the 1940 Act; companies owned 5% to 25%, which represent portfolio companies where the Company directly or indirectly owns 5% to 25% of the outstanding voting securities of such portfolio company or where the Company holds one or more seats on the portfolio company's board of directors and, therefore, are deemed to be an affiliated person under the 1940 Act; and companies less than 5% owned which represent portfolio companies where the Company directly or indirectly owns less than 5% of the outstanding voting securities of such portfolio company and where the Company has no other affiliations with such portfolio company. The interest and related portfolio income and net realized gains (losses) from the commercial real estate finance portfolio and other sources are included in the companies less than 5% owned category on the consolidated statement of operations.

***Valuation of Portfolio Investments***

The Company, as a BDC, invests in illiquid securities including debt and equity securities of companies, non-investment grade CMBS, and the bonds and preferred shares of CDOs. The Company's investments are generally subject to restrictions on resale and generally have no established trading market. The Company values substantially all of its investments at fair value as determined in good faith by the Board of Directors in accordance with the Company's valuation policy. The Company determines fair value to be the amount for which an investment could be exchanged in an orderly disposition over a reasonable period of time between willing parties other than in a forced or liquidation sale. The Company's valuation policy considers the fact that no ready market exists for substantially all of the securities in which it invests. The Company's valuation policy is intended to provide a consistent basis for determining the fair value of the portfolio. The Company will record unrealized depreciation on investments when it believes that an investment has become impaired, including where collection of a loan or realization of an equity security is doubtful, or when the enterprise value of the portfolio company does not currently support the cost of the Company's debt or equity investments. Enterprise value means the entire value of the company to a potential buyer, including the sum of the values of debt and equity securities used to capitalize the enterprise at a point in time. The

**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Information at and for the six months ended  
June 30, 2004 and 2003, is unaudited)**

**Note 2. Summary of Significant Accounting Policies, continued**

Company will record unrealized appreciation if it believes that the underlying portfolio company has appreciated in value and, therefore, the Company's equity security has also appreciated in value. The value of investments in publicly traded securities is determined using quoted market prices discounted for restrictions on resale, if any.

***Loans and Debt Securities***

For loans and debt securities, fair value generally approximates cost unless the borrower's enterprise value, overall financial condition or other factors lead to a determination of fair value at a different amount.

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

Interest income is recorded on an accrual basis to the extent that such amounts are expected to be collected. For loans and debt securities with contractual payment-in-kind interest, which represents contractual interest accrued and added to the loan balance that generally becomes due at maturity, the Company will not accrue payment-in-kind interest if the portfolio company valuation indicates that the payment-in-kind interest is not collectible. Interest on loans and debt securities is not accrued if the Company has doubt about interest collection. Loans in workout status that are classified as Grade 4 or 5 assets under the Company's internal grading system do not accrue interest. In addition, interest may not accrue on loans or debt securities to portfolio companies that are more than 50% owned by the Company depending on such company's working capital needs. Loan origination fees, original issue discount, and market discount are capitalized and then amortized into interest income using the effective interest method. Upon the prepayment of a loan or debt security, any unamortized loan origination fees are recorded as interest income and any unamortized original issue discount or market discount is recorded as a realized gain. Prepayment premiums are recorded on loans and debt securities when received.

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

***Equity Securities***

The Company's equity interests in portfolio companies for which there is no liquid public market are valued at fair value based on the enterprise value of the portfolio company, which is determined using various factors, including cash flow from operations of the portfolio company and other pertinent factors, such as recent offers to purchase a

**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Information at and for the six months ended  
June 30, 2004 and 2003, is unaudited)**

**Note 2. Summary of Significant Accounting Policies, continued**

portfolio company, recent transactions involving the purchase or sale of the portfolio company's equity securities, or other liquidation events. The determined equity values are generally discounted to account for restrictions on resale and minority ownership positions.

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

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

***Commercial Mortgage-Backed Securities ( CMBS ) and Collateralized Debt Obligations ( CDO )***

CMBS bonds and CDO bonds and preferred shares are carried at fair value, which is based on a discounted cash flow model that utilizes prepayment and loss assumptions based on historical experience and projected performance, economic factors, the characteristics of the underlying cash flow, and comparable yields for similar CMBS bonds and CDO bonds and preferred shares. The Company recognizes unrealized appreciation or depreciation on its CMBS bonds and CDO bonds and preferred shares as comparable yields in the market change and/or based on changes in estimated cash flows resulting from changes in prepayment or loss assumptions in the underlying collateral pool.

The Company recognizes income from the amortization of original issue discount using the effective interest method, using the anticipated yield over the projected life of the investment. Yields are revised when there are changes in actual and estimated prepayment speeds or actual and estimated credit losses. Changes in estimated yield are recognized as an adjustment to the estimated yield over the remaining life of the CMBS bonds and CDO bonds and preferred shares from the date the estimated yield is changed.

***Net Realized Gains or Losses and Net Change in Unrealized Appreciation or Depreciation***

Realized gains or losses are measured by the difference between the net proceeds from the repayment or sale and the cost basis of the investment without regard to unrealized appreciation or depreciation previously recognized, and include investments charged off during the year, net of recoveries. Net change in unrealized appreciation or depreciation reflects the change in portfolio investment values during the reporting period, including the reversal of previously recorded unrealized appreciation or depreciation when gains or losses are realized.



ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Information at and for the six months ended  
June 30, 2004 and 2003, is unaudited)

**Note 2. Summary of Significant Accounting Policies, continued**

***Fee Income***

Fee income includes fees for guarantees and services rendered by the Company to portfolio companies and other third parties such as diligence, structuring, transaction services, management services, and other advisory services. Guaranty fees are recognized as income over the related period of the guaranty. Diligence, structuring, and transaction services fees are generally recognized as income when services are rendered or when the related transactions are completed. Management and other advisory services fees are generally recognized as income as the services are rendered.

***Guarantees***

The Company accounts for guarantees under FASB Interpretation No. 45, *Guarantors Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (the Interpretation). In accordance with the Interpretation, guarantees meeting the characteristics described in the Interpretation, and issued or modified after December 31, 2002, are recognized at fair value. However, certain guarantees are excluded from the initial recognition provisions of the Interpretation. See Note 5 for disclosures related to the Company's guarantees.

***Financing Costs***

Debt financing costs are based on actual costs incurred in obtaining debt financing and are deferred and amortized as part of interest expense over the term of the related debt instrument. Costs associated with the issuance of common stock, such as underwriting, accounting and legal fees, and printing costs are recorded as a reduction to the proceeds from the sale of common stock.

***Cash and Cash Equivalents***

Cash and cash equivalents include cash in banks and all highly liquid investments with original maturities of three months or less.

***Dividends to Shareholders***

Dividends to shareholders are recorded on the record date.

***Stock Compensation Plans***

The Company has a stock-based employee compensation plan, which is described more fully in Note 10. The Company accounts for this plan under the recognition and measurement principles of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. No stock-based employee compensation cost is reflected in net increase in net assets resulting from operations, as all options granted under this plan had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net increase in net assets resulting from operations and earnings per share if the Company had applied the fair value

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Information at and for the six months ended  
June 30, 2004 and 2003, is unaudited)

## Note 2. Summary of Significant Accounting Policies, continued

recognition provisions of FASB Statement No. 123, *Accounting for Stock-Based Compensation*, to stock-based employee compensation for the six months ended June 30, 2004 and 2003, and the years ended December 31, 2003, 2002 and 2001.

(in thousands, except per share amounts)	For the Six Months Ended June 30,				
	2004	2003	2003	2002	2001
	(unaudited)				
Net increase in net assets resulting from operations as reported	\$ 115,650	\$ 79,813	\$ 192,011	\$ 228,291	\$ 200,727
Less total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(10,596)	(8,078)	(12,294)	(6,863)	(7,207)
Pro forma net increase in net assets resulting from operations	105,054	71,735	179,717	221,428	193,520
Less preferred stock dividends	(52)	(110)	(210)	(230)	(230)
Pro forma net income available to common shareholders	\$ 105,002	\$ 71,625	\$ 179,507	\$ 221,198	\$ 193,290
Basic earnings per common share:					
As reported	\$ 0.90	\$ 0.71	\$ 1.64	\$ 2.23	\$ 2.19
Pro forma	\$ 0.82	\$ 0.64	\$ 1.54	\$ 2.17	\$ 2.11
Diluted earnings per common share:					
As reported	\$ 0.88	\$ 0.71	\$ 1.62	\$ 2.20	\$ 2.16
Pro forma	\$ 0.80	\$ 0.64	\$ 1.52	\$ 2.14	\$ 2.08

Pro forma expenses are based on the underlying value of the options granted by the Company. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model and expensed over the vesting period. The following weighted average assumptions were used to calculate the fair value of options granted

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Information at and for the six months ended  
June 30, 2004 and 2003, is unaudited)

**Note 2. Summary of Significant Accounting Policies, continued**

during the six months ended June 30, 2004 and 2003, and the years ended December 31, 2003, 2002, and 2001:

	For the Six Months Ended June 30,				
	2004	2003	2003	2002	2001
	(unaudited)				
Risk-free interest rate	2.9%	2.6%	2.8%	3.2%	4.0%
Expected life	5.0	5.0	5.0	5.0	5.0
Expected volatility	37.0%	38.8%	38.4%	39.7%	33.0%
Dividend yield	8.8%	8.9%	8.9%	8.5%	8.0%
Weighted average fair value per option	\$4.19	\$3.31	\$3.47	\$3.78	\$3.24

***Federal and State Income Taxes***

The Company intends to comply with the requirements of the Internal Revenue Code ( Code ) that are applicable to regulated investment companies ( RIC ) and real estate investment trusts ( REIT ). The Company and its subsidiaries that qualify as a RIC or a REIT intend to annually distribute or retain through a deemed distribution all of their taxable income to shareholders; therefore, the Company has made no provision for income taxes for these entities. AC Corp is a corporation subject to federal and state income taxes and records a benefit or expense for income taxes as appropriate.

***Per Share Information***

Basic earnings per common share is calculated using the weighted average number of common shares outstanding for the period presented. Diluted earnings per common share reflects the potential dilution that could occur if options to issue common stock were exercised into common stock. Earnings per share is computed after subtracting dividends on preferred shares.

***Use of Estimates in the Preparation of Financial Statements***

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from these estimates.

The consolidated financial statements include portfolio investments at value of \$2.8 billion, \$2.6 billion and \$2.5 billion at June 30, 2004, and December 31, 2003 and 2002, respectively. At June 30, 2004, and December 31, 2003 and 2002, 87%, 85% and 88%, respectively, of the Company's total assets represented investments whose fair values

**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Information at and for the six months ended  
June 30, 2004 and 2003, is unaudited)**

**Note 2. Summary of Significant Accounting Policies, continued**

have been determined by the Board of Directors in good faith in the absence of readily available market values. Because of the inherent uncertainty of valuation, the Board of Directors determined values 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.

***New Accounting Pronouncements***

In November 2002, the FASB issued Interpretation No. 45, *Guarantors Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (the Interpretation) which expands on the accounting guidance of Statements No. 5, 57 and 107 and incorporates without change the provisions of FASB Interpretation No. 34, which is being superceded. The Interpretation significantly changed the current practice in the accounting for and disclosure of guarantees. Guarantees meeting the characteristics described in the Interpretation are to be recognized at fair value and significant disclosure rules have been implemented even if the likelihood of the guarantor making payments is remote. The disclosure requirements were effective for financial statements of interim or annual periods ending after December 15, 2002, while the initial measurement provisions were applicable on a prospective basis to guarantees issued or modified after December 31, 2002. Certain guarantees are excluded from the initial recognition provisions of the Interpretation, however specific disclosures are still required. The Company applied the initial recognition and measurement provisions for guarantees issued beginning in the first quarter of 2003 and there was no material effect on the Company's financial position or its results of operations. See Note 5 for the disclosures related to the Company's guarantees.

In January 2003, the FASB issued Interpretation No. 46 (FIN 46), *Consolidation of Variable Interest Entities*, which provides new guidance on the consolidation of certain entities defined as variable interest entities. FIN 46 specifies that any enterprise subject to SEC Regulation S-X Rule 6-03(c)(1) shall not consolidate any entity that is not also subject to the same rule. The Company is subject to Rule 6-03(c)(1), therefore FIN 46 does not apply to its portfolio investments. The Company has adopted FIN 46 and the adoption had no effect on the Company's financial position or results of operations.

In May 2003, the FASB issued Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity*, which provides guidance on how an entity classifies and measures such instruments. This statement was effective for financial instruments entered into or modified after May 31, 2003, and otherwise was effective at the beginning of the first interim period beginning after June 15, 2003. The statement requires cumulative effect transition for financial instruments existing at adoption date. The Company has adopted this statement as discussed in Note 6 and this adoption did not have a significant effect on the Company's financial position or its results of operations.

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Information at and for the six months ended  
June 30, 2004 and 2003, is unaudited)

## Note 3. Portfolio

*Private Finance*

At June 30, 2004, and December 31, 2003 and 2002, the private finance portfolio consisted of the following:

(\$ in thousands)	2004			2003			2002		
	Cost	Value	Yield <sup>(1)</sup>	Cost	Value	Yield <sup>(1)</sup>	Cost	Value	Yield <sup>(1)</sup>
	(unaudited)								
Loans and debt securities	\$ 1,463,628	\$ 1,278,076	14.6%	\$ 1,406,052	\$ 1,214,886	15.0%	\$ 1,272,401	\$ 1,151,256	14.4%
Equity interests	606,692	634,390		500,079	687,786		438,501	591,959	
Total	\$ 2,070,320	\$ 1,912,466		\$ 1,906,131	\$ 1,902,672		\$ 1,710,902	\$ 1,743,215	

(1) The weighted average yield on loans and debt securities is computed as the (a) annual stated interest plus the annual amortization of loan origination fees, original issue discount, and market discount on accruing loans and debt securities, divided by (b) total loans and debt securities at value. At June 30, 2004, and December 31, 2003, the cost and value of loans and debt securities include the Class A equity interests in BLX and the guaranteed dividend yield on these equity interests is included in interest income. The weighted average yield is computed as of the balance sheet date.

Private finance investment activity principally involves providing financing through privately negotiated long-term debt and equity investments. Private finance investments are generally issued by private companies and are generally illiquid and subject to restrictions on resale or transferability. Private finance investments are generally structured as loans and debt securities that carry a relatively high fixed rate of interest, which may be combined with equity features, such as conversion privileges, or warrants or options to purchase a portion of the portfolio company's equity at a pre-determined strike price, which is generally a nominal price for warrants or options in a private company. The annual stated interest rate is only one factor in pricing the investment relative to our rights and priority in the portfolio company's capital structure, and will vary depending on many factors, including if the Company has received nominal cost equity or other components of investment return, such as loan origination fees or market discount. The stated interest rate may include some component of contractual payment-in-kind interest, which represents contractual interest accrued and added to the loan balance that generally becomes due at maturity. At June 30, 2004, and December 31, 2003 and 2002, approximately 99%, 97% and 95%, respectively, of the Company's loans and debt securities had fixed interest rates.

Loans and debt securities generally have a maturity of five to ten years, with interest-only payments in the early years and payments of both principal and interest in the later years, although debt maturities and principal amortization schedules vary.

Equity interests consist primarily of securities issued by private companies and may be subject to restrictions on their resale and are generally illiquid. Equity securities generally do not produce a current return, but are held in anticipation of investment appreciation and ultimate gain on sale.

The Company's most significant investments at June 30, 2004, were in Business Loan Express, LLC and Advantage Sales & Marketing, Inc. The Company's most significant investments at December 31, 2003 and 2002, were in Business Loan Express, LLC and



**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Information at and for the six months ended  
June 30, 2004 and 2003, is unaudited)**

**Note 3. Portfolio, continued**

The Hillman Companies, Inc. The Company's investment in Hillman Companies, Inc. was sold on March 31, 2004.

At June 30, 2004, and December 31, 2003 and 2002, the Company had an investment at value totaling \$352.8 million, \$342.2 million and \$256.8 million, respectively, in Business Loan Express, LLC (BLX), a small business lender that participates in the U.S. Small Business Administration's 7(a) Guaranteed Loan Program. At June 30, 2004, and December 31, 2003, the Company owned 94.9% of the voting Class C equity interests. BLX has an equity appreciation rights plan for management which will dilute the value available to the Class C equity interest holders. BLX is headquartered in New York, NY.

During the three months ended June 30, 2004, the Company provided BLX a new \$20 million revolving credit facility for working capital. At June 30, 2004, BLX had outstanding borrowings of \$10 million on the facility. This \$10 million was repaid by BLX after the end of the second quarter, and there are currently no amounts outstanding under this facility.

During the first quarter of 2003, the Company invested \$50 million in BLX in the form of a \$25 million short-term line of credit and \$25 million of preferred equity in connection with BLX's acquisition of \$128 million in assets from Amresco Independence Funding, Inc. As of December 31, 2003, the \$25 million short-term line of credit had been fully repaid to the Company. BLX also completed its corporate reorganization to a limited liability company during the first quarter of 2003 by merging BLX, Inc. into BLX, LLC. Prior to this transaction, BLX converted \$43 million of the Company's subordinated debt to preferred stock in BLX, Inc., which was exchanged upon the merger for Class A equity interests of BLX, LLC. In addition, as part of the merger, the Company exchanged its existing preferred stock and common equity investments in BLX, Inc. for similar classes of members' equity in BLX, LLC represented by Class B and Class C equity interests, respectively.

As a limited liability company, BLX's taxable income flows through directly to its members. BLX's annual taxable income generally differs from its book income for the fiscal year due to temporary and permanent differences in the recognition of income and expenses. The Company holds all of BLX's Class A and Class B interests, and 94.9% of the Class C interests. BLX's taxable income is first allocated to the Class A interests to the extent that dividends are paid in cash or in kind on such interests, with the remainder being allocated to the Class B and Class C interests. BLX declares dividends on its Class B interests based on an estimate of its annual taxable income allocable to such interests.

BLX paid dividends to the Company in cash or in kind on the Class A interests totaling \$6.1 million, \$4.6 million and \$10.4 million for the six months ended June 30, 2004 and 2003, and the year ended December 31, 2003, respectively. For the six months ended June 30, 2004 and 2003, and the year ended December 31, 2003, total dividends on the Class A interests included paid in kind dividends of \$3.0 million, \$2.2 million and \$5.0 million, respectively. The guaranteed dividend yield on these equity interests is

**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Information at and for the six months ended  
June 30, 2004 and 2003, is unaudited)**

**Note 3. Portfolio, continued**

included in interest income. In addition, BLX paid dividends to the Company on the Class B interests totaling \$4.8 million, \$2.0 million and \$7.8 million for the six months ended June 30, 2004 and 2003, and the year ended December 31, 2003, respectively. These dividends were paid to the Company through the issuance of additional Class B equity interests. The Class B dividends are included in dividend income. Net change in unrealized appreciation or depreciation for the six months ended June 30, 2004, includes \$9.3 million of unrealized depreciation related to BLX, and net change in unrealized appreciation or depreciation for the six months ended June 30, 2003, and for the years ended December 31, 2003, 2002 and 2001, include \$56.7 million, \$51.7 million, \$19.9 million and \$15.5 million of unrealized appreciation related to BLX.

At the time of the corporate reorganization of BLX, Inc. from a C corporation to a limited liability company in 2003, for tax purposes BLX had a built-in gain representing the aggregate fair market value of its assets in excess of the tax basis of its assets. As a regulated investment company, the Company will be subject to special built-in gain rules on the assets of BLX. Under these rules, taxes will be payable by the Company at the time and to the extent that the built-in gains on BLX's assets at the date of reorganization are recognized in a taxable disposition of such assets in the 10-year period following the date of the reorganization. At such time, the built-in gains realized upon the disposition of these assets will be included in the Company's taxable income, net of the corporate level taxes paid by the Company on the built-in gains. However, if these assets are disposed of after the 10-year period, there will be no corporate level taxes on these built-in gains.

While the Company has no obligation to pay the built-in gains tax until these assets are disposed of in the future, it may be necessary to record a liability for these taxes in the future should the Company intend to sell the assets of BLX within the 10-year period. The Company estimates that its future tax liability resulting from the built-in gains at the date of BLX's reorganization may total up to \$40 million. At June 30, 2004, and December 31, 2003, the Company considered the increase in fair value of its investment in BLX due to BLX's tax attributes as an LLC and has also considered the reduction in fair value of its investment due to these estimated built-in gain taxes in determining the fair value of its investment in BLX.

As the controlling equity owner of BLX, the Company has provided an unconditional guaranty to the BLX credit facility lenders in an amount up to 50% of the total obligations (consisting of principal, letters of credit issued under the facility, accrued interest, and other fees) on BLX's three-year unsecured \$275.0 million revolving credit facility, which includes a sub-facility for the issuance of letters of credit for up to a total of \$50.0 million. The facility matures in January 2007. The amount guaranteed by the Company at June 30, 2004, was \$86.6 million. This guaranty can be called by the lenders only in the event of a default by BLX. BLX was in compliance with the terms of its credit facility at June 30, 2004. At June 30, 2004, the Company had also provided four standby letters of credit totaling \$35.6 million in connection with four term securitization transactions completed by BLX. In consideration for providing the guaranty and the standby letters of credit, BLX paid the Company fees of \$2.8 million, \$1.9 million, \$4.1 million, \$3.1 million and



**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Information at and for the six months ended  
June 30, 2004 and 2003, is unaudited)**

**Note 3. Portfolio, continued**

\$2.3 million for the six months ended June 30, 2004 and 2003, and the years ended December 31, 2003, 2002, and 2001, respectively.

On June 30, 2004, the Company completed the purchase of a majority ownership stake in the business of Advantage Sales & Marketing, Inc. ( Advantage ). At June 30, 2004, the Company's investment totaled \$257.2 million at cost and value. At the closing of the transaction, the Company invested \$90.2 million in loans and subordinated debt and \$73.5 million in common stock. In addition, prior to completing the purchase, the Company had invested \$93.7 million in subordinated debt in certain predecessor companies of Advantage, of which \$45.5 million was invested during the second quarter of 2004. This existing debt was exchanged for new subordinated debt in Advantage as part of the transaction. Advantage is a leading sales and marketing agency providing outsourced sales, merchandising, and marketing services to the consumer packaged goods industry. Advantage has offices across the country and is headquartered in Irvine, CA.

At December 31, 2003 and 2002, the Company had an investment in The Hillman Companies, Inc. ( Hillman ) totaling \$234.5 million and \$180.5 million at value, respectively. On March 31, 2004, the Company sold Hillman for a total transaction value of \$510 million, including the repayment of outstanding debt and adding the value of Hillman's outstanding trust preferred shares. The Company was repaid its existing \$44.6 million in outstanding mezzanine debt. Total consideration to the Company from the sale at closing, including the repayment of debt, was \$244.3 million, which included net cash proceeds of \$196.8 million and the receipt of a new subordinated debt instrument of \$47.5 million. For the six months ended June 30, 2004, the Company realized a gain of \$150.2 million on the transaction, including a gain of \$1.2 million realized during the second quarter of 2004, resulting from post-closing adjustments, which provided additional cash consideration to the Company in the same amount. The sale of Hillman is subject to certain other post-closing adjustments. During the second quarter of 2004, the Company sold a \$5.0 million participation in its subordinated debt in Hillman to a third party, which reduced the Company's investment, and no gain or loss resulted from the transaction.

Total interest and related portfolio income earned from the Company's investments in BLX, Advantage and Hillman for the six months ended June 30, 2004, was \$22.9 million, \$3.0 million and \$3.3 million, respectively. Total interest and related portfolio income earned from the Company's investments in BLX and Hillman for the six months ended June 30, 2003, were \$22.7 million and \$4.8 million, respectively.

Total interest and related portfolio income earned from BLX for the years ended December 31, 2003, 2002, and 2001, was \$46.7 million, \$40.2 million, and \$33.1 million, respectively. Total interest and related portfolio income earned from Hillman for the years ended December 31, 2003, 2002, and 2001, was \$9.7 million, \$9.3 million, and \$6.5 million, respectively.

Investing activities in portfolio companies more than 25% owned during the six months ended June 30, 2004, also included an \$82.7 million debt and equity investment, including closing costs, to purchase a majority ownership stake in Mercury Air Centers,

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Information at and for the six months ended  
June 30, 2004 and 2003, is unaudited)

**Note 3. Portfolio, continued**

Inc.; a \$6.6 million debt and equity investment, including closing costs, to purchase Legacy Partners Group, LLC; an equity investment of \$7.5 million and an exchange of existing subordinated debt with a cost basis of \$7.3 million for equity interests in an affiliate of Impact Innovations Group, LLC; and an exchange of existing debt securities, along with accrued and unpaid interest thereon, with a total cost basis of \$49.8 million for \$12.5 million of new debt and a 68.5% common stock interest in Startec Global Communications Corporation ( Startec ) upon its emergence from bankruptcy in May 2004. The Company also provided a \$2.2 million term loan to Startec for working capital.

At June 30, 2004, and December 31, 2003 and 2002, loans and debt securities at value not accruing interest were as follows:

	2004	2003	2002
(\$ in thousands)	(unaudited)		
Loans and debt securities in workout status (classified as Grade 4 or 5)			
Companies more than 25% owned	\$ 32,682	\$ 31,873	\$ 9,709
Companies 5% to 25% owned	15,965	2,777	411
Companies less than 5% owned	42,281	28,027	65,931
Loans and debt securities not in workout status			
Companies more than 25% owned	22,240	31,897	63,577
Companies 5% to 25% owned			7,166
Companies less than 5% owned	40,338	16,532	
Total	\$ 153,506	\$ 111,106	\$ 146,794

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Information at and for the six months ended  
June 30, 2004 and 2003, is unaudited)

**Note 3. Portfolio, continued**

The industry and geographic compositions of the private finance portfolio at value at June 30, 2004, and December 31, 2003 and 2002, were as follows:

	2004	2003	2002
	(unaudited)		
<b>Industry</b>			
Business services	35%	22%	24%
Consumer products	19	30	34
Financial services	19	19	16
Healthcare services	8	8	6
Industrial products	5	6	8
Energy services	4	4	2
Retail	3	4	4
Telecommunications	2	2	2
Broadcasting and cable	2	2	1
Other	3	3	3
	—	—	—
Total	100%	100%	100%
	—	—	—
<b>Geographic Region</b>			
Mid-Atlantic	38%	40%	33%
West	33	16	15
Midwest	14	26	30
Southeast	10	13	17
Northeast	5	4	4
International		1	1
	—	—	—
Total	100%	100%	100%
	—	—	—

**Commercial Real Estate Finance**

At June 30, 2004, and December 31, 2003 and 2002, the commercial real estate finance portfolio consisted of the following:

	2004			2003			2002		
	Cost	Value	Yield <sup>(1)</sup>	Cost	Value	Yield <sup>(1)</sup>	Cost	Value	Yield <sup>(1)</sup>
	(unaudited)								
(\$ in thousands)									
CMBS bonds	\$ 543,902	\$ 530,796	13.0%	\$ 399,106	\$ 393,979	14.1%	\$ 523,671	\$ 555,519	14.2%
CDO bonds and preferred shares	175,645	175,608	17.3%	186,824	186,557	16.7%	52,818	52,818	17.2%
Loans	150,382	146,951	8.5%	87,427	83,639	8.6%	66,546	63,707	7.5%
Residual interest							69,335	69,035	9.4%

Edgar Filing: - Form

Real estate owned	16,074	14,444	15,931	12,856	5,942	3,873
Equity interests	5,751	4,549	5,641	4,896		
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Total	\$ 891,754	\$ 872,348	\$ 694,929	\$ 681,927	\$ 718,312	\$ 744,952
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>

(1) The weighted average yield on the interest-bearing investments is computed as the (a) annual stated interest plus the annual amortization of loan origination fees, original issue discount, and market discount on accruing interest-bearing investments, divided by (b) total interest-bearing investments at value. The

F-42

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Information at and for the six months ended  
June 30, 2004 and 2003, is unaudited)

## Note 3. Portfolio, continued

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.

**CMBS Bonds.** At June 30, 2004, and December 31, 2003 and 2002, CMBS bonds consisted of the following:

	2004	2003	2002
(\$ in thousands)	(unaudited)		
Face	\$ 1,269,851	\$ 1,016,533	\$ 1,173,194
Original issue discount	(725,949)	(617,427)	(649,523)
Cost	\$ 543,902	\$ 399,106	\$ 523,671
Value	\$ 530,796	\$ 393,979	\$ 555,519

The underlying rating classes of the CMBS bonds at cost and value at June 30, 2004, and December 31, 2003 and 2002, were as follows:

	2004			2003			2002		
	Cost	Value	Percentage of Total Value	Cost	Value	Percentage of Total Value	Cost	Value	Percentage of Total Value
(\$ in thousands)	(unaudited)								
BBB-	\$ 22,295	\$ 21,495	4.0%	\$	\$	%	\$	\$	%
BB+	78,151	79,587	15.0	49,477	51,157	13.0	45,609	49,811	9.0
BB	44,418	45,410	8.6	22,031	23,008	5.9	34,603	39,011	7.0
BB-	29,754	30,281	5.7	13,538	14,266	3.6	19,629	22,030	4.0
B+	60,664	60,661	11.4	54,464	54,246	13.8	109,235	121,038	21.8
B	55,042	55,917	10.5	38,416	38,362	9.7	131,309	141,998	25.6
B-	89,236	87,537	16.5	84,986	83,859	21.3	83,493	83,493	15.0
CCC+	23,799	19,969	3.8	15,935	15,494	3.9			
CCC	23,209	18,099	3.4	13,323	11,413	2.9	8,634	8,634	1.5
CCC-				3,133	2,410	0.6			
CC	1,474	965	0.2						
Unrated	115,860	110,875	20.9	103,803	99,764	25.3	91,159	89,504	16.1
Total	\$ 543,902	\$ 530,796	100.0%	\$ 399,106	\$ 393,979	100.0%	\$ 523,671	\$ 555,519	100.0%

The BBB- rated, non-investment grade and unrated tranches of the CMBS bonds in which the Company invests are junior in priority for payment of interest and principal to the more senior tranches of the related CMBS bond issuance. Cash flow from the underlying mortgages is generally allocated first to the senior tranches in order of priority, with the most senior tranches having a priority right to the cash flow. Then, any remaining cash flow is allocated, generally, among the other tranches in order of their relative seniority. To the extent there are defaults and unrecoverable losses on the underlying mortgages or the properties securing those mortgages resulting in reduced cash flows, the most subordinate tranche will bear this loss first. At June 30, 2004, the face value of the CMBS bonds held by the Company were subordinate to 80% to 99% of the face value of the bonds issued in these various CMBS transactions. At December 31, 2003, the face value of the CMBS bonds

held by the Company were subordinate to 87% to 99% of the

F-43

---

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Information at and for the six months ended  
June 30, 2004 and 2003, is unaudited)

**Note 3. Portfolio, continued**

face value of the bonds issued in these various CMBS transactions. Given that the non-investment grade CMBS bonds in which the Company invests are junior in priority for payment of interest and principal, the Company invests in these CMBS bonds at a discount from the face amount of the bonds.

At June 30, 2004, and December 31, 2003 and 2002, the Company held CMBS bonds in 47, 38 and 27 separate CMBS issuances, respectively. The underlying collateral pool, consisting of commercial mortgage loans and real estate owned ( REO ) properties, for these CMBS issuances consisted of the following at June 30, 2004, and December 31, 2003 and 2002:

	2004	2003	2002
	(unaudited)		
(\$ in millions)			
Approximate number of loans and REO properties <sup>(1)</sup>	6,400	5,600	4,500
Total outstanding principal balance	\$46,336	\$38,437	\$24,974
Loans over 30 days delinquent or classified as REO properties <sup>(2)</sup>	1.2% <sup>(3)</sup>	1.5% <sup>(3)</sup>	1.0% <sup>(3)</sup>

(1) Includes approximately 35, 22 and 12 REO properties obtained through the foreclosure of commercial mortgage loans at June 30, 2004, and December 31, 2003 and 2002, respectively.

(2) As a percentage of total outstanding principal balance.

(3) At June 30, 2004, and December 31, 2003 and 2002, the Company's investments included bonds in the first loss, unrated bond class in 40, 34 and 27 separate CMBS issuances, respectively. For these issuances, loans over 30 days delinquent or classified as REO properties were 1.5%, 1.7% and 1.0% of the total outstanding principal balance at June 30, 2004, and December 31, 2003 and 2002, respectively.

The property types and the geographic composition of the underlying mortgage loans and REO properties in the underlying collateral pools for all CMBS issuances calculated using the outstanding principal balance at June 30, 2004, and December 31, 2003 and 2002, were as follows:

	2004	2003	2002
	(unaudited)		
<b>Property Type</b>			
Retail	33%	35%	32%
Office	31	24	21
Housing	21	25	27
Industrial	5	5	7
Hospitality	4	5	6
Other	6	6	7
	—	—	—
Total	100%	100%	100%

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Information at and for the six months ended  
June 30, 2004 and 2003, is unaudited)

## Note 3. Portfolio, continued

	2004	2003	2002
	(unaudited)		
<b>Geographic Region</b>			
West	28%	31%	31%
Mid-Atlantic	27	27	25
Midwest	22	21	22
Southeast	17	17	17
Northeast	6	4	5
	—	—	—
Total	100%	100%	100%
	—	—	—

The Company's yield on its CMBS bonds is based upon a number of assumptions that are subject to certain business and economic uncertainties and contingencies. Examples include the timing and magnitude of credit losses on the mortgage loans underlying the CMBS bonds that are a result of the general condition of the real estate market, including vacancies, changes in market rental rates and tenant credit quality. The initial yield on each CMBS bond has generally been computed assuming an approximate 1% loss rate on its underlying collateral mortgage pool, with the estimated losses being assumed to occur in three equal installments in years three, six, and nine. As each CMBS bond ages, the expected amount of losses and the expected timing of recognition of such losses will be updated, and the respective yield will be adjusted as appropriate. As these uncertainties and contingencies are difficult to predict and are subject to future events which may alter these assumptions, no assurance can be given that the anticipated yields to maturity will be achieved.

At June 30, 2004, and December 31, 2003 and 2002, the unamortized discount related to the CMBS bond portfolio was \$725.9 million, \$617.4 million and \$649.5 million, respectively, and the Company had set aside \$356.1 million, \$295.8 million and \$237.0 million, respectively, of this unamortized discount to absorb potential future losses. The yields on the CMBS bonds of 13.0%, 14.1% and 14.2%, respectively, assume that this amount that has been set aside will not be amortized.

At December 31, 2003, the Company had reduced the face amount and the original issue discount on the CMBS bonds for specifically identified losses of \$52.6 million, which had the effect of also reducing the amount of unamortized discount set aside to absorb potential future losses since those losses have now been recognized. The reduction of the face amount and the original issue discount on the CMBS bonds to reflect specifically identified losses will not result in a change in the cost basis of the CMBS bonds.

At June 30, 2004 and December 31, 2003 and 2002, CMBS bonds with a value of \$49 thousand, \$0.2 million and \$28 thousand, respectively, were not accruing interest.

**Collateralized Debt Obligation Bonds and Preferred Shares ( CDOs ).** At June 30, 2004, the Company owned BB rated bonds in two CDOs totaling \$2.8 million at value and preferred shares in eight CDOs totaling \$172.8 million at value. At December 31, 2003,



## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Information at and for the six months ended  
June 30, 2004 and 2003, is unaudited)

**Note 3. Portfolio, continued**

the Company owned BBB rated bonds in one CDO totaling \$16.0 million at value, BB rated bonds in one CDO totaling \$0.9 million at value and preferred shares in seven CDOs totaling \$169.7 million at value. At December 31, 2002, the Company owned preferred shares in four CDOs totaling \$52.8 million at value.

The bonds and preferred shares of the CDOs in which the Company has invested are junior in priority for payment of interest and principal to the more senior tranches of debt issued by the CDOs. Cash flow from the underlying collateral generally is allocated first to the senior bond tranches in order of priority, with the most senior tranches having a priority right to the cash flow. Then, any remaining cash flow is generally distributed to the preferred shareholders. To the extent there are defaults and unrecoverable losses on the underlying collateral that result in reduced cash flows, the preferred shares will bear this loss first and then the bonds would bear any loss after the preferred shares. At June 30, 2004, the Company's bonds and preferred shares in the CDOs were subordinate to 70% to 98% of the more senior tranches of debt issued in the various CDO transactions. At December 31, 2003, the Company's bonds in the CDO were subordinate to 61% to 93% of the more senior tranches of debt issued in the CDO transactions and the preferred shares in the CDOs were subordinate to 84% to 98% of the more senior tranches of debt issued in the various CDO transactions. In addition, included in the CMBS collateral for the CDOs at June 30, 2004, and December 31, 2003 and 2002, were certain CMBS bonds that are senior in priority of repayment to certain lower rated CMBS bonds held directly by the Company.

At June 30, 2004, and December 31, 2003 and 2002, the underlying collateral for the Company's investment in the outstanding CDO issuances had balances as follows:

(\$ in millions)	2004	2003	2002
	<b>(unaudited)</b>		
Investment grade REIT debt <sup>(1)</sup>	\$1,404.1	\$1,338.0	\$1,016.9
Investment grade CMBS bonds <sup>(2)</sup>	805.6	662.3	494.2
Non-investment grade CMBS bonds <sup>(3)</sup>	1,185.3	1,133.7	438.3
Other collateral	120.2	32.4	8.2
	<hr/>	<hr/>	<hr/>
Total collateral	\$3,515.2	\$3,166.4	\$1,957.6
	<hr/>	<hr/>	<hr/>

(1) Issued by 44, 44 and 40 REITs, respectively, for the respective periods presented.

(2) Issued in 97, 78 and 43 transactions, respectively, for the respective periods presented.

(3) Issued in 77, 68 and 33 transactions, respectively, for the respective periods presented.

The initial yields on the CDO bonds and preferred shares are based on the estimated future cash flows from the assets in the underlying collateral pool to be paid to these CDO classes. As each CDO bond and preferred share ages, the estimated future cash flows will be updated based on the estimated performance of the collateral, and the respective yield will be adjusted as necessary. As future cash flows are subject to uncertainties and

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Information at and for the six months ended  
June 30, 2004 and 2003, is unaudited)

**Note 3. Portfolio, continued**

contingencies that are difficult to predict and are subject to future events which may alter current assumptions, no assurance can be given that the anticipated yields to maturity will be achieved.

As of June 30, 2004 and 2003, and December 31, 2003, 2002, and 2001, the Company acted as the disposition consultant with respect to five, four, five, three and one, respectively, of the CDOs, which allows the Company to approve disposition plans for individual collateral securities. For these services, the Company collects annual fees based on the outstanding collateral pool balance, and for the six months ended June 30, 2004 and 2003, and the years ended December 31, 2003, 2002, and 2001, these fees totaled \$0.9 million, \$0.5 million, \$1.2 million, \$0.5 million and \$0.1 million, respectively.

**Loans and Equity Interests.** The commercial mortgage loan portfolio contains loans that were originated by the Company or were purchased from third-party sellers. At June 30, 2004, approximately 96% and 4% of the Company's commercial mortgage loan portfolio was composed of fixed and adjustable interest rate loans, respectively. At December 31, 2003, approximately 92% and 8% of the Company's commercial mortgage loan portfolio was composed of fixed and adjustable interest rate loans, respectively. As of December 31, 2002, approximately 84% and 16% of the Company's commercial mortgage loan portfolio was composed of fixed and adjustable interest rate loans, respectively. As of June 30, 2004, and December 31, 2003 and 2002, loans with a value of \$17.0 million, \$6.8 million and \$13.0 million, respectively, were not accruing interest. Loans greater than 120 days delinquent generally do not accrue interest.

Equity interests consist primarily of equity securities issued by privately owned companies that invest in single real estate properties. These equity interests may be subject to restrictions on their resale and are generally illiquid. Equity interests generally do not produce a current return, but are generally held in anticipation of investment appreciation and ultimate realized gain on sale.

The property types and the geographic composition securing the commercial mortgage loans and equity interests at value at June 30, 2004, and December 31, 2003 and 2002, were as follows:

	2004	2003	2002
	(unaudited)		
<b>Property Type</b>			
Retail	57%	21%	21%
Hospitality	25	41	23
Office	13	22	20
Housing	3	4	8
Healthcare		7	15
Other	2	5	13
	—	—	—
Total	100%	100%	100%
	—	—	—

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Information at and for the six months ended  
June 30, 2004 and 2003, is unaudited)

## Note 3. Portfolio, continued

	2004	2003	2002
	_____	_____	_____
	(unaudited)		
<b>Geographic Region</b>			
Southeast	45%	34%	40%
Midwest	33	30	12
West	12	20	20
Mid-Atlantic	6	9	17
Northeast	4	7	11
	_____	_____	_____
Total	100%	100%	100%
	_____	_____	_____

**Residual Interest.** At December 31, 2002, the Company had \$68.8 million at cost and value of residual interest and \$0.5 million at cost and \$0.2 million at value of residual interest spread.

The residual interest primarily consisted of a retained interest from a 1998 asset securitization. During April 2003, the call provision was exercised and, accordingly, the bondholders were repaid in full and the remaining available cash, loans, and real estate owned by the trust were subsequently returned to the Company as payment on the residual interest. Therefore, the cost and value were zero at December 31, 2003.

At December 31, 2002, the Company used a discounted cash flow methodology for determining the fair value of its retained residual interest and residual interest spread ( Residual ). In determining the cash flow of the Residual, the Company assumed a prepayment speed of 15% after the applicable prepayment lockout period and credit losses of 1% or approximately \$0.8 million of the total principal balance of the underlying collateral throughout the life of the collateral. These assumptions resulted in an expected weighted average life of the bonds of four months. The value of the resulting Residual cash flows at December 31, 2002, was then determined by applying a discount rate of 9% which, in the Company's view, was commensurate with the market risk of comparable assets.

**Tax Basis**

At December 31, 2003 and 2002, the aggregate gross unrealized appreciation of the Company's investments over cost for federal income tax purposes was \$429.8 million and \$303.0 million, respectively. At December 31, 2003 and 2002, the aggregate gross unrealized depreciation of the Company's investments below cost for federal income tax purposes was \$319.1 million and \$196.2 million, respectively. The aggregate net unrealized appreciation of the Company's investments over cost for federal income tax purposes was \$110.7 million and \$106.8 million at December 31, 2003 and 2002. At December 31, 2003 and 2002, the aggregate cost of securities, for federal income tax purposes was \$2.5 billion and \$2.4 billion, respectively.

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Information at and for the six months ended  
June 30, 2004 and 2003, is unaudited)**Note 4. Debt**

At June 30, 2004, and December 31, 2003 and 2002, the Company had the following debt:

	2004			2003			2002		
	Facility Amount	Amount Drawn	Annual Interest Cost <sup>(1)</sup>	Facility Amount	Amount Drawn	Annual Interest Cost <sup>(1)</sup>	Facility Amount	Amount Drawn	Annual Interest Cost <sup>(1)</sup>
(\$ in thousands)	(unaudited)								
Notes payable and debentures:									
Unsecured notes payable	\$ 757,080	\$ 757,080	7.1%	\$ 854,000	\$ 854,000	7.2%	\$ 694,000	\$ 694,000	7.7%
SBA debentures	94,800	87,500	8.1%	101,800	94,500	8.1%	101,800	94,500	8.2%
OPIC loan	5,700	5,700	6.6%	5,700	5,700	6.6%	5,700	5,700	6.6%
Total notes payable and debentures	857,580	850,280	7.2%	961,500	954,200	7.3%	801,500	794,200	7.8%
Revolving line of credit	552,500	208,500	5.1%(2)	532,500		(2)	527,500	204,250	3.7%(2)
Total debt	\$ 1,410,080	\$ 1,058,780	6.8%(2)	\$ 1,494,000	\$ 954,200	7.5%(2)	\$ 1,329,000	\$ 998,450	6.9%(2)

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

(2) The stated interest rate payable on the revolving line of credit was 3.8% at June 30, 2004, which excluded the annual cost of commitment fees and other facility fees of \$2.8 million. There were no amounts drawn on the revolving line of credit at December 31, 2003, and the annual cost of commitment fees and other facility fees was \$2.7 million. The stated interest rate payable on the revolving line of credit was 2.7% at December 31, 2002, which excluded the annual cost of commitment fees and other facility fees of \$2.0 million. The annual interest cost for total debt includes the annual cost of commitment fees and other facility fees on the revolving line of credit regardless of the amount drawn on the facility as of the balance sheet date.

**Notes Payable and Debentures**

**Unsecured Notes Payable.** The Company has issued unsecured long-term notes to private institutional investors. The notes require semi-annual interest payments until maturity and have original terms of five or seven years. At June 30, 2004 and December 31, 2003, the notes had remaining maturities of four months to six years. During the second quarter of 2004, the Company repaid \$112.0 million of these notes that matured on May 1, 2004. The notes may be prepaid in whole or in part, together with an interest premium, as stipulated in the note agreement.

On March 25, 2004, the Company issued five-year unsecured long-term notes denominated in Euros and Sterling for a total U.S. dollar equivalent of \$15.2 million. The notes have fixed interest rates and have substantially the same terms as the Company's existing unsecured notes. The Euro notes require annual interest payments and the Sterling notes require semi-annual interest payments until maturity. Simultaneous with issuing the notes, the Company entered into a cross-currency swap with a financial institution which fixed the Company's interest and principal payments in U.S. dollars for the life of the debt.

On May 14, 2003, the Company issued \$153 million of five-year and \$147 million of seven-year unsecured long-term notes, primarily to insurance companies. The five- and



## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Information at and for the six months ended  
June 30, 2004 and 2003, is unaudited)

**Note 4. Debt, continued**

seven-year notes have fixed interest rates of 5.45% and 6.05%, respectively, and have substantially the same terms as the Company's existing unsecured long-term notes. On May 30, 2003, \$140 million of the Company's existing unsecured long-term notes matured and the Company used the proceeds from the new long-term note issuance to repay this debt.

**SBA Debentures.** At June 30, 2004, and December 31, 2003 and 2002, the Company had debentures payable to the SBA with original terms of ten years and at fixed interest rates ranging from 5.9% to 7.6%, 5.9% to 8.2% and 5.9% to 8.2%, respectively. During the first quarter of 2004, the Company repaid \$7.0 million of the SBA debentures. At June 30, 2004, the debentures had remaining maturities of one to eight years. At December 31, 2003, the debentures had remaining maturities of nine months to eight years. The debentures require semi-annual interest-only payments with all principal due upon maturity. The SBA debentures are subject to prepayment penalties if paid prior to the fifth anniversary date of the notes. At June 30, 2004, the Company had a commitment from the SBA to borrow up to an additional \$7.3 million above the current amount outstanding. The commitment expires on September 30, 2005.

**Scheduled Maturities.** Scheduled future maturities of notes payable and debentures at June 30, 2004, were as follows:

Year	Amount Maturing
	(\$ in thousands) (unaudited)
2004	\$ 102,000
2005	179,000
2006	180,700
2007	
2008	153,000
Thereafter	235,580
	<hr/>
Total	\$ 850,280
	<hr/>

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Information at and for the six months ended  
June 30, 2004 and 2003, is unaudited)

**Note 4. Debt, continued**

Scheduled future maturities of notes payable and debentures at December 31, 2003, were as follows:

Year	Amount Maturing
	(\$ in thousands)
2004	\$ 221,000
2005	179,000
2006	180,700
2007	
2008	153,000
Thereafter	220,500
	<hr/>
Total	\$ 954,200
	<hr/>

***Revolving Line of Credit***

The committed amount under the unsecured revolving credit facility was expanded during the second quarter of 2004 to \$552.5 million and may be further expanded through new or additional commitments up to \$600.0 million at the Company's option. The committed amount under the unsecured revolving credit facility was \$532.5 million at December 31, 2003. The renewed line of credit expires in April 2005 and may be extended under substantially similar terms for one additional year at the Company's option. The facility generally bears interest at a rate, at the Company's option, equal to (i) the one-month LIBOR plus 1.50%, (ii) the Bank of America, N.A. cost of funds plus 1.50% or (iii) the higher of the Bank of America, N.A. prime rate or the Federal Funds rate plus 0.50%. The interest rate adjusts at the beginning of each new interest period, usually every 30 days. The facility requires an annual commitment fee equal to 0.25% of the committed amount. The annual cost of commitment fees and other facility fees was \$2.8 million, \$2.7 million and \$2.0 million at June 30, 2004, and December 31, 2003 and 2002, respectively. The line of credit generally requires monthly payments of interest, and all principal is due upon maturity.

The average debt outstanding on the revolving line of credit was \$1.9 million, \$78.0 million, \$41.5 million and \$68.3 million for the six months ended June 30, 2004 and 2003, and for the years ended December 31, 2003 and 2002, respectively. The maximum amount borrowed under this facility and the weighted average stated interest rate for the six months ended June 30, 2004 and 2003, and for the years ended December 31, 2003 and 2002, were \$208.5 million and 3.7%, \$208.8 million and 2.7%, \$208.8 million and 2.0%, and \$216.5 million and 3.2%, respectively. As of June 30, 2004, the amount available under the revolving line of credit was \$300.1 million, net of amounts committed for standby letters of credit of \$43.9 million issued under the credit facility. As of December 31, 2003, the amount available under the revolving line of credit was \$487.0 million, net of amounts committed for standby letters of credit of \$45.5 million issued under the credit facility.

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Information at and for the six months ended  
June 30, 2004 and 2003, is unaudited)

**Note 4. Debt, continued**

The Company records debt at cost. The fair value of the Company's outstanding debt was approximately \$1.0 billion and \$1.1 billion at December 31, 2003 and 2002, respectively. The fair value of the Company's debt was determined using market interest rates as of the balance sheet date for similar instruments.

**Covenant Compliance**

The Company has various financial and operating covenants required by the notes payable and debentures and the revolving line of credit. These covenants require the Company to maintain certain financial ratios, including debt to equity and interest coverage, and a minimum net worth. The Company's credit facilities limit its ability to declare dividends if the Company defaults under certain provisions. As of June 30, 2004, and December 31, 2003, the Company was in compliance with these covenants.

**Note 5. Guarantees and Other Commitments**

In the ordinary course of business, the Company has issued guarantees and has extended standby letters of credit through financial intermediaries on behalf of certain portfolio companies. All standby letters of credit have been issued through Bank of America, N.A. As of June 30, 2004, and December 31, 2003 and 2002, the Company had issued guarantees of debt, rental obligations, lease obligations and severance obligations aggregating \$92.6 million, \$83.4 million and \$54.6 million, respectively, and had extended standby letters of credit aggregating \$43.9 million, \$45.5 million and \$11.3 million, respectively. Under these arrangements, the Company would be required to make payments to third-party beneficiaries if the portfolio companies were to default on their related payment obligations. The maximum amount of future payments was \$136.5 million, \$128.9 million and \$65.9 million at June 30, 2004, and December 31, 2003 and 2002, respectively. At June 30, 2004, and December 31, 2003 and 2002, no amounts had been recorded as a liability for the Company's guarantees or standby letters of credit.

As of June 30, 2004, the guarantees and standby letters of credit expire as follows:

(in millions)	Total	2004	2005	2006	2007	2008	After 2008
Guarantees	\$ 92.6	\$ 0.5	\$ 0.6	\$ 1.1	\$ 86.8	\$	\$ 3.6
Standby letters of credit <sup>(1)</sup>	43.9	—	1.2	42.7	—	—	—
<b>Total</b>	<b>\$ 136.5</b>	<b>\$ 0.5</b>	<b>\$ 1.8</b>	<b>\$ 43.8</b>	<b>\$ 86.8</b>	<b>\$</b>	<b>\$ 3.6</b>

(1) Standby letters of credit are issued under the Company's revolving line of credit that expires in April 2005 and may be extended under substantially similar terms for one additional year at the Company's option, for an assumed maturity of April 2006. Therefore, unless a standby letter of credit is set to expire at an earlier date, it is assumed that the standby letters of credit will expire contemporaneously with the expiration of the Company's line of credit in April 2006.



## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Information at and for the six months ended  
June 30, 2004 and 2003, is unaudited)

**Note 5. Guarantees and Other Commitments, continued**

As of December 31, 2003, the guarantees and standby letters of credit expire as follows:

(in millions)	Total	2004	2005	2006	2007	2008	After 2008
Guarantees	\$ 83.4	\$79.0	\$0.4	\$ 0.2	\$0.2	\$	\$3.6
Standby letters of credit	45.5	—	3.0	42.5	—	—	—
<b>Total</b>	<b>\$128.9</b>	<b>\$79.0</b>	<b>\$3.4</b>	<b>\$42.7</b>	<b>\$0.2</b>	<b>\$</b>	<b>\$3.6</b>

In the ordinary course of business, the Company enters into agreements with service providers and other parties that may contain provisions for the Company to indemnify such parties under certain circumstances.

**Note 6. Preferred Stock**

At December 31, 2003 and 2002, Allied Investment has outstanding a total of 60,000 shares of \$100 par value, 3% cumulative preferred stock and 10,000 shares of \$100 par value, 4% redeemable cumulative preferred stock issued to the SBA pursuant to Section 303(c) of the Small Business Investment Act of 1958, as amended. The 3% cumulative preferred stock did not have a required redemption date. Allied Investment had the option to redeem in whole or in part the preferred stock by paying the SBA the par value of such securities and any dividends accumulated and unpaid to the date of redemption. The 4% redeemable cumulative preferred stock had a required redemption date in June 2005. In April 2004, Allied Investment redeemed the preferred stock by paying the SBA the par value of such securities plus any dividends accumulated and unpaid to the date of redemption.

In accordance with SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity*, (SFAS No. 150) the Company has reclassified the 10,000 shares of \$100 par value, 4% redeemable cumulative preferred securities to other liabilities on the accompanying consolidated balance sheet. Accordingly, the Company has also recorded the associated dividends as interest expense on the accompanying consolidated statement of operations beginning with the quarter ended September 30, 2003. The effect of this change in accounting principle was not material to the financial results or the results of operations of the Company. Also, in accordance with SFAS No. 150, no previously reported amounts have been reclassified.

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Information at and for the six months ended  
June 30, 2004 and 2003, is unaudited)**Note 7. Shareholders Equity**

Sales of common stock for the six months ended June 30, 2004 and 2003, and the years ended December 31, 2003, 2002, and 2001, were as follows:

(in thousands)	For the Six Months Ended June 30,				
	2004	2003	2003	2002	2001
	(unaudited)				
Number of common shares		7,050	18,700	8,047	13,286
Gross proceeds	\$	\$152,632	\$442,680	\$177,345	\$301,539
Less costs, including underwriting fees		(7,506)	(20,675)	(4,498)	(14,651)
Net proceeds	\$	\$145,126	\$422,005	\$172,847	\$286,888

In addition, the Company issued 123,814 shares of common stock with a value of \$3.2 million to acquire one portfolio investment during the six months ended June 30, 2004, 32,266 shares of common stock with a value of \$0.9 million to acquire one portfolio investment during 2003, and 204,855 shares of common stock with a value of \$5.2 million to acquire one portfolio investment in a stock-for-stock exchange during 2001.

The Company has a dividend reinvestment plan, whereby the Company may buy shares of its common stock in the open market or issue new shares in order to satisfy dividend reinvestment requests. If the Company issues new shares, the issue price is equal to the average of the closing sale prices reported for the Company's common stock for the five consecutive trading days immediately prior to the dividend payment date. For the six months ended June 30, 2004 and 2003, and the years ended December 31, 2003, 2002 and 2001, the Company issued new shares in order to satisfy dividend reinvestment requests.

Dividend reinvestment plan activity for the six months ended June 30, 2004 and 2003, and the years ended December 31, 2003, 2002, and 2001, was as follows:

(in thousands, except per share amounts)	For the Six Months Ended June 30,				
	2004	2003	2003	2002	2001
	(unaudited)				
Shares issued	110	154	279	275	271
Average price per share	\$26.91	\$21.50	\$23.60	\$22.78	\$23.32

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Information at and for the six months ended  
June 30, 2004 and 2003, is unaudited)

**Note 8. Earnings Per Common Share**

Earnings per common share for the six months ended June 30, 2004 and 2003, and the years ended December 31, 2003, 2002, and 2001, were as follows:

	For the Six Months Ended June 30,				
	2004	2003	2003	2002	2001
(in thousands, except per share amounts)	(unaudited)				
Net increase in net assets resulting from operations	\$ 115,650	\$ 79,813	\$ 192,011	\$ 228,291	\$ 200,727
Less preferred stock dividends	(52)	(110)	(210)	(230)	(230)
Income available to common shareholders	\$ 115,598	\$ 79,703	\$ 191,801	\$ 228,061	\$ 200,497
Weighted average common shares outstanding basic	128,564	111,510	116,747	102,107	91,564
Dilutive options outstanding to officers	3,056	781	1,604	1,467	1,439
Weighted average common shares outstanding diluted	131,620	112,291	118,351	103,574	93,003
Basic earnings per common share	\$ 0.90	\$ 0.71	\$ 1.64	\$ 2.23	\$ 2.19
Diluted earnings per common share	\$ 0.88	\$ 0.71	\$ 1.62	\$ 2.20	\$ 2.16

**Note 9. 401(k) Plan and Deferred Compensation Plans**

The Company's 401(k) retirement investment plan is open to all of its full-time employees who are at least 21 years of age. The employees may elect voluntary pre-tax wage deferrals ranging from 0% to 100% of eligible compensation for the year up to \$12 thousand annually for the 2003 plan year. Plan participants who reached the age of 50 during the 2003 plan year were eligible to defer an additional \$2 thousand during the year. The Company makes contributions to the 401(k) plan of up to 5% of each participant's eligible compensation for the year up to a maximum compensation permitted by the IRS, which fully vests at the time of contribution. For the year ended December 31, 2003, the maximum compensation was \$200 thousand. Employer contributions that exceed the IRS limitation are directed to the participant's deferred compensation plan account. Total 401(k) contribution expense for the years ended December 31, 2003, 2002, and 2001, was \$0.7 million, \$0.6 million and \$0.6 million, respectively.

The Company also has a deferred compensation plan. Eligible participants in the deferred compensation plan may elect to defer some of their compensation and have such compensation credited to a participant account. In addition, the Company makes

**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Information at and for the six months ended  
June 30, 2004 and 2003, is unaudited)**

**Note 9. 401(k) Plan and Deferred Compensation Plans, continued**

contributions to the deferred compensation plan to the extent 401(k) contributions for eligible participants exceed the amount permitted by the IRS. Contribution expense for the deferred compensation plan for the years ended December 31, 2003, 2002, and 2001, was \$0.4 million, \$0.3 million and \$0.3 million, respectively. All amounts credited to a participant's account are credited solely for purposes of accounting and computation and remain assets of the Company and subject to the claims of the Company's general creditors. Amounts credited to participants under the deferred compensation plan are at all times 100% vested and non-forfeitable. A participant's account shall become distributable upon his or her separation from service, retirement, disability, death, or at a future determined date. All deferred compensation plan accounts will be distributed in the event of a change of control of the Company or in the event of the Company's insolvency. Amounts deferred by participants under the deferred compensation plan are funded to a trust, which is administered by Company-appointed trustees.

In the first quarter of 2004, the Company established the Individual Performance Award (IPA) as a long-term incentive compensation program for its senior officers. In conjunction with the program, the Company has approved a non-qualified deferred compensation plan (DCP II), which is administered through a trust. The administrator of the DCP II is the Compensation Committee of the Company's Board of Directors (DCP II Administrator) and the DCP II trust is administered by a Company-appointed trustee.

The IPA, which will generally be determined annually at the beginning of each year, will be deposited in the trust in four equal installments, generally on a quarterly basis, in the form of cash. The Compensation Committee has designed the DCP II to then require the trustee to use the cash exclusively to purchase shares of the Company's common stock in the open market.

All amounts deposited and then credited to a participant's account in the trust, based on the amount of the IPA received by such participant, are credited solely for purposes of accounting and computation and remain assets of the Company and subject to the claims of the Company's general creditors. Amounts credited to participants under the DCP II are immediately vested and non-forfeitable once deposited by the Company into the trust. A participant's account shall generally become distributable only after his or her termination of employment, or in the event of a change of control of the Company. Upon the participant's termination of employment, one-third of the participant's account will be immediately distributed, one-half of the then current remaining balance will be distributed on the first anniversary of his or her employment termination date and the remainder of the account balance will be distributed on the second anniversary of the employment termination date. Distributions are subject to the participant's adherence to certain non-solicitation requirements. All DCP II accounts will be distributed in a single lump sum in the event of a change of control of the Company. To the extent that a participant has an employment agreement, such participant's DCP II account will be fully distributed in the event that such participant's employment is terminated for good reason as defined under

**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Information at and for the six months ended  
June 30, 2004 and 2003, is unaudited)**

**Note 9. 401(k) Plan and Deferred Compensation Plans, continued**

that participant's employment agreement. The DCP II Administrator may also determine other distributable events and the timing of such distributions. Sixty days following a distributable event, the Company and each participant may, at the discretion of the Company, and subject to the Company's trading window during that time, redirect the participant's account to other investment options.

During any period of time in which a participant has an account in the DCP II, any dividends declared and paid on shares of the Company's common stock allocated to the participant's account shall be reinvested by the trustee as soon as practicable in shares of the Company's common stock purchased in the open market.

For the six months ended June 30, 2004, the Company recorded \$7.0 million in IPA expense. These amounts were contributed into the DCP II trust and invested in the Company's common stock. The accounts of the DCP II are consolidated with the Company's accounts. The common stock is classified as common stock held in deferred compensation trust in the accompanying financial statements and the deferred compensation obligation, which represents the amount owed to the employees, is included in other liabilities. Changes in the value of the Company's common stock are not recognized in the common stock held in deferred compensation trust. However, the obligation is adjusted with a corresponding charge or credit to compensation expense. The effect of this adjustment for the six months ended June 30, 2004, was to reduce the individual performance award expense by \$0.6 million. This resulted in a total IPA expense of \$6.4 million for the six months ended June 30, 2004.

**Note 10. Stock Option Plan**

***The Option Plan***

The purpose of the stock option plan (Option Plan) is to provide officers and non-officer directors of the Company with additional incentives. Options are exercisable at a price equal to the fair market value of the shares on the day the option is granted. Each option states the period or periods of time within which the option may be exercised by the optionee, which may not exceed ten years from the date the option is granted. The options granted vest ratably over a three- or five-year period.

All rights to exercise options terminate 60 days after an optionee ceases to be (i) a non-officer director, (ii) both an officer and a director, if such optionee serves in both capacities, or (iii) an officer (if such officer is not also a director) of the Company for any cause other than death or total and permanent disability. In the event of a change of control of the Company, all outstanding options will become fully vested and exercisable as of the change of control.

On May 12, 2004, the Company's shareholders amended the Option Plan to increase the authorized number of shares under the plan to 32.2 million. At December 31, 2003, there were 26.0 million shares authorized under the Option Plan. At June 30, 2004, and

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Information at and for the six months ended  
June 30, 2004 and 2003, is unaudited)

**Note 10. Stock Option Plan, continued**

December 31, 2003, the number of shares available to be granted under the Option Plan was 7.2 million and 8.8 million, respectively.

Information with respect to options granted, exercised and forfeited under the Option Plan for the six months ended June 30, 2004, and the years ended December 31, 2003, 2002, and 2001, is as follows:

(in thousands, except per share amounts)	Shares	Weighted Average Exercise Price Per Share
Options outstanding at January 1, 2001	8,906	\$ 18.76
Granted	2,800	\$ 21.82
Exercised	(553)	\$ 19.09
Forfeited	(673)	\$ 17.66
	<hr/>	
Options outstanding at December 31, 2001	10,480	\$ 19.63
	<hr/>	
Granted	6,162	\$ 22.07
Exercised	(769)	\$ 18.85
Forfeited	(1,184)	\$ 21.09
	<hr/>	
Options outstanding at December 31, 2002	14,689	\$ 20.57
	<hr/>	
Granted	1,045	\$ 22.74
Exercised	(408)	\$ 21.01
Forfeited	(442)	\$ 21.66
	<hr/>	
Options outstanding at December 31, 2003	14,884	\$ 20.68
	<hr/>	
Granted	7,880	\$ 28.47
Exercised	(608)	\$ 19.80
Forfeited	(85)	\$ 21.37
	<hr/>	
Options outstanding at June 30, 2004	22,071	\$ 23.48
	<hr/>	

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Information at and for the six months ended  
June 30, 2004 and 2003, is unaudited)

## Note 10. Stock Option Plan, continued

The following table summarizes information about stock options outstanding at June 30, 2004:

Range of Exercise Prices	Outstanding			Exercisable	
	Total Number Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Total Number Exercisable	Weighted Average Exercise Price
(in thousands, except per share amounts and years)					
\$16.81 \$21.38	5,518	5.01	\$ 18.67	5,411	\$ 18.67
\$21.52	5,098	8.45	\$ 21.52	3,379	\$ 21.52
\$21.59 \$26.73	4,415	8.16	\$ 23.11	2,426	\$ 22.76
\$27.00 \$27.38	250	9.00	\$ 27.15	104	\$ 27.24
\$28.98	6,790	9.70	\$ 28.98	1,697	\$ 28.98
\$16.81 \$27.38	22,071	7.92	\$ 23.48	13,017	\$ 21.59

The following table summarizes information about stock options outstanding at December 31, 2003:

Range of Exercise Prices	Outstanding			Exercisable	
	Total Number Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Total Number Exercisable	Weighted Average Exercise Price
(in thousands, except per share amounts and years)					
\$16.81 \$17.75	3,175	6.35	\$ 16.94	3,099	\$ 16.92
\$17.88 \$21.38	2,828	4.49	\$ 20.72	2,777	\$ 20.73
\$21.52	5,243	8.95	\$ 21.52	1,732	\$ 21.52
\$21.59 \$25.47	2,998	8.11	\$ 21.94	1,555	\$ 21.76
\$25.53 \$27.38	640	8.54	\$ 26.32	207	\$ 26.40
\$16.81 \$27.38	14,884	7.36	\$ 20.68	9,370	\$ 19.91

The Company accounts for its stock options as required by APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and accordingly no compensation cost has been recognized as the exercise price equals the market price on the date of grant.





## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Information at and for the six months ended  
June 30, 2004 and 2003, is unaudited)

**Note 10. Stock Option Plan, continued***Notes Receivable from the Sale of Common Stock*

As a business development company under the Investment Company Act of 1940, the Company is entitled to provide and has provided loans to the Company's officers in connection with the exercise of options. However, as a result of provisions of the Sarbanes-Oxley Act of 2002, the Company is prohibited from making new loans to its executive officers in the future. The outstanding loans are full recourse, have varying terms not exceeding ten years, bear interest at the applicable federal interest rate in effect at the date of issue and have been recorded as a reduction to shareholders' equity. At June 30, 2004, and December 31, 2003 and 2002, the Company had outstanding loans to officers of \$8.6 million, \$18.6 million and \$24.7 million, respectively. Officers with outstanding loans repaid principal of \$10.0 million, \$1.7 million, \$6.1 million, \$3.7 million and \$5.1 million, for the six months ended June 30, 2004 and 2003, and the years ended December 31, 2003, 2002, and 2001, respectively. The Company recognized interest income from these loans of \$0.4 million, \$0.7 million, \$1.3 million, \$1.5 million and \$1.5 million, respectively, during these same periods. This interest income is included in interest and dividends for companies less than 5% owned.

**Note 11. Dividends and Distributions**

The Company's Board of Directors declared and the Company paid a dividend of \$0.57 per common share for the first and second quarters of 2004 and 2003. These dividends totaled \$146.8 million and \$127.5 million for the six months ended June 30, 2004 and 2003, respectively. The Company declared an extra cash dividend of \$0.03 per share during 2002 and this was paid to shareholders on January 9, 2003. The Company's Board of Directors also declared a dividend of \$0.57 per common share for the third quarter of 2004.

For the years ended December 31, 2003, 2002, and 2001, the Company declared the following distributions:

	2003		2002		2001	
	Total Amount	Total Per Share	Total Amount	Total Per Share	Total Amount	Total Per Share
(\$ in thousands, except per share amounts)						
First quarter	\$ 62,971	\$0.57	\$ 53,259	\$0.53	\$ 42,080	\$0.49
Second quarter	64,503	0.57	56,224	0.55	45,755	0.50
Third quarter	68,685	0.57	57,340	0.56	47,866	0.51
Fourth quarter	71,679	0.57	59,851	0.56	50,456	0.51
Extra dividend			3,261	0.03		
Total distributions to common shareholders	\$267,838	\$2.28	\$229,935	\$2.23	\$186,157	\$2.01

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Information at and for the six months ended  
June 30, 2004 and 2003, is unaudited)

## Note 11. Dividends and Distributions, continued

For income tax purposes, distributions for 2003, 2002, and 2001, were composed of the following:

	2003		2002		2001	
	Total Amount	Total Per Share	Total Amount	Total Per Share	Total Amount	Total Per Share
(\$ in thousands, except per share amounts)						
Ordinary income <sup>(1)</sup>	\$212,272	\$1.81	\$178,246	\$1.73	\$183,957	\$1.99
Long-term capital gains	55,566	0.47	51,689	0.50	2,200	0.02
Total distributions to common shareholders <sup>(2)</sup>	\$267,838	\$2.28	\$229,935	\$2.23	\$186,157	\$2.01

(1) For the year ended December 31, 2003, ordinary income included dividend income of approximately \$0.05 per share that qualified to be taxed at the new 15% maximum capital gains rate.

(2) For certain eligible corporate shareholders, the dividend received deduction for 2003 was \$0.044 per share.

The following table summarizes the differences between financial statement net increase in net assets resulting from operations and taxable income available for distribution to shareholders for the years ended December 31, 2003, 2002, and 2001:

	2003	2002	2001
Financial statement net increase in net assets resulting from operations	\$192,011	\$228,291	\$200,727
Adjustments:			
Net change in unrealized appreciation or depreciation	78,466	571	(20,603)
Amortization of discounts and fees	(3,187)	(10,097)	8,043
Interest- and dividend-related items	(3,716)	8,787	(1,345)
Employee compensation-related items	2,875	867	(66)
Income (loss) from partnerships and limited liability companies	(389)	(3,822)	(1,406)
Income (loss) from securitized commercial mortgage loans	(251)	1,258	3,327
(Income) loss from consolidated taxable subsidiary, net of tax	3,864	(1,160)	193
Other	(555)	4,740	(1,036)
Taxable income	\$269,118	\$229,435	\$187,834

The Company must distribute at least 90% of its investment company taxable income to qualify for pass-through tax treatment and maintain its RIC status. The Company has distributed and currently intends to distribute or retain through a deemed distribution sufficient dividends to

eliminate taxable income.

F-61

---

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Information at and for the six months ended  
June 30, 2004 and 2003, is unaudited)

**Note 11. Dividends and Distributions, continued**

The Company's consolidated subsidiary, AC Corp, is subject to federal and state income taxes. As a result, the Company recorded a tax benefit of \$0.5 million, a tax benefit of \$1.1 million, a tax benefit of \$2.5 million, a tax expense of \$0.9 million and a tax benefit of \$0.4 million, respectively, for the six months ended June 30, 2004 and 2003, and the years ended December 31, 2003, 2002, and 2001. At June 30, 2004, and December 31, 2003 and 2002, the Company had a net deferred tax asset of \$3.7 million, \$3.1 million and \$0.4 million, respectively, which was composed primarily of net operating loss carry forwards. Management believes that the realization of the net deferred tax asset is more likely than not based on expectations as to future taxable income and scheduled reversals of temporary differences. Accordingly, the Company did not record a valuation allowance at June 30, 2004, or December 31, 2003 or 2002.

**Note 12. Cash and Cash Equivalents**

The Company places its cash with financial institutions and, at times, cash held in checking accounts in financial institutions may be in excess of the Federal Deposit Insurance Corporation insured limit.

At June 30, 2004, and December 31, 2003 and 2002, cash and cash equivalents consisted of the following:

	2004	2003	2002
(\$ in thousands)	(unaudited)		
Cash and cash equivalents	\$95,270	\$218,160	\$15,497
Less escrows held	(2,488)	(3,993)	(4,311)
	<u>          </u>	<u>          </u>	<u>          </u>
Total cash and cash equivalents	\$92,782	\$214,167	\$11,186
	<u>          </u>	<u>          </u>	<u>          </u>

**Note 13. Supplemental Disclosure of Cash Flow Information**

For the six months ended June 30, 2004 and 2003, the Company paid \$38.2 million and \$35.2 million, respectively, for interest.

Non-cash operating activities for the six months ended June 30, 2004, include notes or other securities received as consideration from the sale of investments of \$52.9 million. The notes received for the six months ended June 30, 2004, include a note received for \$47.5 million in conjunction with the sale of the Company's investment in Hillman (see Note 3). Non-cash operating activities for the six months ended June 30, 2004, also included an exchange of \$48.3 million of subordinated debt in certain predecessor companies of Advantage Sales & Marketing, Inc. for new subordinated debt in Advantage; an exchange of existing debt securities with a cost basis of \$46.4 million for new debt and common stock in Startec Global Communications Corporation; and an exchange of existing subordinated debt with a cost basis of \$7.3 million for equity interests in an affiliate of Impact Innovations Group, LLC (see Note 3).

**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Information at and for the six months ended  
June 30, 2004 and 2003, is unaudited)**

**Note 13. Supplemental Disclosure of Cash Flow Information, continued**

Non-cash operating activities for the six months ended June 30, 2003, included the receipt of commercial mortgage loans and real estate owned in the repayment of the Company's Residual Interest totaling \$69.3 million, real estate owned received in connection with foreclosure on commercial mortgage loans of \$2.2 million, and receipt of commercial mortgage loans in satisfaction of private finance loans and debt securities of \$9.1 million.

For the six months ended June 30, 2004, the Company's non-cash financing activities totaled \$3.0 million related to the issuance of common stock in lieu of cash distributions, and \$3.2 million related to the issuance of common stock as consideration to acquire one portfolio investment. For the six months ended June 30, 2003, the Company's non-cash financing activities totaled \$3.3 million related to the issuance of common stock in lieu of cash distributions.

For the years ended December 31, 2003, 2002, and 2001, the Company paid \$73.8 million, \$69.1 million and \$63.2 million, respectively, for interest.

Non-cash operating activities for the year ended December 31, 2003, included transfers of commercial mortgage loans and real estate owned in the repayment of the Company's residual interest totaling \$69.3 million, real estate owned received in connection with foreclosure on commercial mortgage loans of \$9.1 million, receipt of commercial mortgage loans in satisfaction of private finance loans and debt securities of \$9.1 million and receipt of a note as consideration from the sale of real estate owned of \$3.0 million. Non-cash operating activities for the years ended December 31, 2002 and 2001, included real estate owned received in connection with foreclosure on commercial mortgage loans of \$2.5 million and \$0.7 million, respectively.

For the years ended December 31, 2003, 2002, and 2001, the Company's non-cash financing activities totaled \$6.6 million, \$8.6 million and \$17.5 million, respectively, and includes stock option exercises and dividend reinvestment. The non-cash financing activities for the years ended December 31, 2003 and 2001, also includes the issuance of \$0.9 million and \$5.2 million, respectively, of the Company's common stock as consideration to acquire portfolio investments.

**Note 14. Hedging Activities**

The Company invests in CMBS and CDO bonds, which are purchased at prices that are based in part on comparable Treasury rates. The Company has entered into transactions with one or more financial institutions to hedge against movement in Treasury rates on certain of the higher rated CMBS and CDO bonds. These transactions, referred to as short sales, involve the Company receiving the proceeds from the short sales of borrowed Treasury securities, with the obligation to replenish the borrowed Treasury securities at a later date based on the then current market price. Borrowed Treasury securities and the related obligations to replenish the borrowed Treasury securities at value,

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Information at and for the six months ended  
June 30, 2004 and 2003, is unaudited)

**Note 14. Hedging Activities, continued**

including accrued interest payable on the obligations, as of June 30, 2004, and December 31, 2003 and 2002, consisted of the following:

(\$ in thousands) Description of Issue	2004	2003	2002
	(unaudited)		
5-year Treasury securities, due November 2007	\$ 7,043	\$ 7,185	\$ 37,647
5-year Treasury securities, due February 2008		5,977	
5-year Treasury securities, due March 2009	10,805		
5-year Treasury securities, due April 2009	2,147		
5-year Treasury securities, due May 2009	5,489		
10-year Treasury securities, due February 2012			52,053
10-year Treasury securities, due November 2012	9,122	9,357	107,327
10-year Treasury securities, due February 2013	21,843	32,226	
10-year Treasury securities, due May 2013	5,124	5,281	
10-year Treasury securities, due August 2013	20,715	23,666	
10-year Treasury securities, due November 2013	33,268	14,833	
10-year Treasury securities, due February 2014	37,333		
10-year Treasury securities, due May 2014	11,883		
Total	\$ 164,772	\$ 98,525	\$ 197,027

As of June 30, 2004, and December 31, 2003, the total obligations to replenish borrowed Treasury securities had decreased since the related original sale dates due to changes in the yield on the borrowed Treasury securities, resulting in unrealized appreciation on the obligations of \$5.2 million and \$0.6 million, respectively. As of December 31, 2002, the total obligations to replenish borrowed Treasury securities had increased since the related original sale dates due to changes in the yield on the borrowed Treasury securities, resulting in unrealized depreciation on the obligations of \$7.1 million.

The net proceeds related to the sales of the borrowed Treasury securities were \$169.2 million, \$98.5 million and \$189.3 million at June 30, 2004, and December 31, 2003 and 2002, respectively. Under the terms of the transactions, the Company had received cash payments of \$4.4 million at June 30, 2004, and had provided additional cash collateral of \$2.7 million and \$5.4 million at December 31, 2003 and 2002, respectively, for the difference between the net proceeds related to the sales of the borrowed Treasury securities and the obligations to replenish the securities.

The Company has deposited the proceeds related to the sales of the borrowed Treasury securities and the additional cash collateral with Wachovia Capital Markets, LLC under repurchase agreements. The repurchase agreements are collateralized by U.S. Treasury securities and are settled weekly. As of June 30, 2004, the repurchase agreements were due on July 7, 2004, and had a weighted average interest rate of 0.8%. The weighted average interest rate on the repurchase agreements as of December 31, 2003 and 2002, was 0.3% and 0.8%, respectively.

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Information at and for the six months ended  
June 30, 2004 and 2003, is unaudited)

## Note 15. Financial Highlights

	At and for the Six Months Ended June 30,		At and for the Years Ended December 31,		
	2004 <sup>(1)</sup>	2003	2003	2002	2001
	(unaudited)				
<b>Per Common Share Data<sup>(2)</sup></b>					
Net asset value, beginning of period	\$ 14.94	\$ 14.22	\$ 14.22	\$ 13.57	\$ 12.11
Net investment income	0.71	0.78	1.65	1.77	1.93
Net realized gains <sup>(3)</sup>	1.33	0.51	0.63	0.44	0.01
Net change in unrealized appreciation or depreciation <sup>(3)</sup>	(1.16)	(0.58)	(0.66)	(0.01)	0.22
Net increase in net assets resulting from operations	0.88	0.71	1.62	2.20	2.16
Net decrease in net assets from shareholder distributions	(1.14)	(1.14)	(2.28)	(2.23)	(2.01)
Net increase in net assets from capital share transactions	0.09	0.44	1.38	0.68	1.31
Net asset value, end of period	\$ 14.77	\$ 14.23	\$ 14.94	\$ 14.22	\$ 13.57
Market value, end of period	\$ 24.42	\$ 23.10	\$ 27.88	\$ 21.83	\$ 26.00
Total return <sup>(4)</sup>	(9)%	12%	41%	(7)%	36%
<b>Ratios and Supplemental Data</b>					
(\$ and shares in thousands, except per share amounts)					
Ending net assets	\$ 1,904,711	\$ 1,651,143	\$ 1,914,577	\$ 1,546,071	\$ 1,352,123
Common shares outstanding at end of period	128,960	116,034	128,118	108,698	99,607
Diluted weighted average common shares outstanding	131,620	112,291	118,351	103,574	93,003
Employee and administrative expenses/average net assets <sup>(5)</sup>	2.06%	1.68%	3.50%	3.82%	3.80%
Total expenses/average net assets	4.01%	4.02%	8.06%	8.75%	9.31%
Net investment income/average net assets	4.92%	5.47%	11.51%	12.94%	15.15%
Net increase in net assets resulting from operations/ average net assets	6.09%	5.00%	11.33%	15.98%	16.99%
Portfolio turnover rate	16.64%	17.26%	31.12%	15.12%	10.04%
Average debt outstanding	\$ 922,073	\$ 927,009	\$ 943,507	\$ 938,148	\$ 847,121
Average debt per share <sup>(2)</sup>	\$ 7.01	\$ 8.26	\$ 7.97	\$ 9.06	\$ 9.11

(1) The results for the six months ended June 30, 2004, are not necessarily indicative of the operating results to be expected for the full period.

## Edgar Filing: - Form

- (2) Based on diluted weighted average number of common shares outstanding for the period.
- (3) Net realized gains and net change in unrealized appreciation or depreciation can fluctuate significantly from period to period. As a result, quarterly comparisons may not be meaningful.

F-65

---



## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Information at and for the six months ended  
June 30, 2004 and 2003, is unaudited)

**Note 15. Financial Highlights, continued**

- (4) Total return assumes the reinvestment of all dividends paid for the periods presented.
- (5) Employee expenses for the six months ended June 30, 2004, include the expense related to the individual performance award totaling \$6.4 million.

**Note 16. Selected Quarterly Data (Unaudited)**

(\$ in thousands, except per share amounts)	2003			
	Qtr. 1	Qtr. 2	Qtr. 3	Qtr. 4
Total interest and related portfolio income	\$73,130	\$77,214	\$88,870	\$90,015
Net investment income	\$42,670	\$44,598	\$53,608	\$54,254
Net increase in net assets resulting from operations	\$19,873	\$59,940	\$33,744	\$78,454
Basic earnings per common share	\$ 0.18	\$ 0.53	\$ 0.28	\$ 0.63
Diluted earnings per common share	\$ 0.18	\$ 0.52	\$ 0.28	\$ 0.62

(\$ in thousands, except per share amounts)	2002			
	Qtr. 1	Qtr. 2	Qtr. 3	Qtr. 4
Total interest and related portfolio income	\$82,391	\$73,193	\$76,329	\$78,015
Net investment income	\$53,869	\$42,561	\$45,094	\$42,401
Net increase in net assets resulting from operations	\$55,961	\$73,454	\$45,520	\$53,356
Basic earnings per common share	\$ 0.56	\$ 0.72	\$ 0.44	\$ 0.51
Diluted earnings per common share	\$ 0.55	\$ 0.71	\$ 0.44	\$ 0.51

**Note 17. Litigation**

The Company is party to certain lawsuits in the normal course of business. While the outcome of these legal proceedings cannot at this time be predicted with certainty, the Company does not expect that these proceedings will have a material effect upon the Company's financial condition or results of operations.

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATING BALANCE SHEET

December 31, 2003

	Allied Capital	Allied Investment	Others	Eliminations	Consolidated Total
(in thousands)					
<b>ASSETS</b>					
Portfolio at value:					
Private finance	\$ 1,774,077	\$ 110,957	\$ 17,638	\$	\$ 1,902,672
Commercial real estate finance	624,665	1,775	55,487		681,927
Investments in subsidiaries	100,879			(100,879)	
Total portfolio at value	2,499,621	112,732	73,125	(100,879)	2,584,599
Deposits of proceeds from sales of borrowed Treasury securities	98,527				98,527
Accrued interest and dividends receivable	48,806	3,733	540		53,079
Other assets	34,187	3,818	31,493		69,498
Intercompany notes and receivables	75,735	20	18,921	(94,676)	
Cash and cash equivalents	171,364	26,315	16,488		214,167
Total assets	\$ 2,928,240	\$ 146,618	\$ 140,567	\$ (195,555)	\$ 3,019,870
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>					
Liabilities:					
Notes payable and debentures	\$ 859,700	\$ 94,500	\$	\$	\$ 954,200
Revolving line of credit					
Obligations to replenish borrowed Treasury securities	98,525				98,525
Accounts payable and other liabilities	26,148	3,493	16,927		46,568
Intercompany notes and payables	29,290	7,883	57,503	(94,676)	
Total liabilities	1,013,663	105,876	74,430	(94,676)	1,099,293
Commitments and contingencies					
Preferred stock		6,000			6,000
Shareholders' equity:					
Common stock	13		1	(1)	13
Additional paid-in capital	1,985,652	41,486	79,527	(121,013)	1,985,652
Notes receivable from sale of common stock	(18,632)				(18,632)
Net unrealized depreciation on portfolio	(39,055)	(36,524)	(6,772)	43,296	(39,055)
Undistributed (distributions in excess of) earnings	(13,401)	29,780	(6,619)	(23,161)	(13,401)
Total shareholders' equity	1,914,577	34,742	66,137	(100,879)	1,914,577
Total liabilities and shareholders equity	\$ 2,928,240	\$ 146,618	\$ 140,567	\$ (195,555)	\$ 3,019,870



## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATING STATEMENT OF OPERATIONS

For the Year Ended December 31, 2003

	Allied Capital	Allied Investment	Others	Eliminations	Consolidated Total
(in thousands)					
Interest and Related Portfolio Income					
Interest and dividends	\$ 271,291	\$ 13,332	\$ 6,096	\$	\$ 290,719
Intercompany interest	3,399			(3,399)	
Premiums from loan dispositions	7,231	515	426		8,172
Income from investments in wholly owned subsidiaries	9,513			(9,513)	
Fees and other income	12,387	663	30,448	(13,160)	30,338
<b>Total interest and related portfolio income</b>	<b>303,821</b>	<b>14,510</b>	<b>36,970</b>	<b>(26,072)</b>	<b>329,229</b>
Expenses					
Interest	69,185	8,042	6		77,233
Intercompany interest			3,399	(3,399)	
Employee	15,305		21,640		36,945
Administrative	21,869	54	13,624	(13,160)	22,387
<b>Total operating expenses</b>	<b>106,359</b>	<b>8,096</b>	<b>38,669</b>	<b>(16,559)</b>	<b>136,565</b>
Net investment income before income taxes	197,462	6,414	(1,699)	(9,513)	192,664
Income tax expense (benefit)	4		(2,470)		(2,466)
<b>Net investment income</b>	<b>197,458</b>	<b>6,414</b>	<b>771</b>	<b>(9,513)</b>	<b>195,130</b>
Net Realized and Unrealized Gains (Losses)					
Net realized gains	73,019	2,154	174		75,347
Net change in unrealized appreciation or depreciation	(78,466)	(24,677)	(2,569)	27,246	(78,466)
<b>Total net gains (losses)</b>	<b>(5,447)</b>	<b>(22,523)</b>	<b>(2,395)</b>	<b>27,246</b>	<b>(3,119)</b>
<b>Net increase (decrease) in net assets resulting from operations</b>	<b>\$ 192,011</b>	<b>\$ (16,109)</b>	<b>\$ (1,624)</b>	<b>\$ 17,733</b>	<b>\$ 192,011</b>

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATING STATEMENT OF CASH FLOWS

For the Year Ended December 31, 2003

	Allied Capital	Allied Investment	Others	Eliminations	Consolidated Total
(in thousands)					
Cash flows from operating activities					
Net increase (decrease) in net assets resulting from operations	\$ 192,011	\$(16,109)	\$ (1,624)	\$ 17,733	\$ 192,011
Adjustments					
Portfolio investments	(890,605)	(36,961)	(3,000)		(930,566)
Repayments of investment principal	283,178	38,721	16,254		338,153
Proceeds from investment sales	430,900		14,914		445,814
Change in accrued or reinvested interest and dividends	(46,223)	1,271			(44,952)
Net change in intercompany investments	2,693	86	(12,292)	9,513	
Amortization of discounts and fees	(11,101)	(744)			(11,845)
Changes in other assets and liabilities	(3,181)	680	(3,569)		(6,070)
Depreciation and amortization			1,638		1,638
Notes received as consideration from sale of equity interests	(1,243)	(425)			(1,668)
Realized losses	11,495	6,393	1,070		18,958
Net change in unrealized appreciation or depreciation	78,466	24,677	2,569	(27,246)	78,466
Net cash provided by operating activities	46,390	17,589	15,960		79,939
Cash flows from financing activities					
Sale of common stock	422,005				422,005
Sale of common stock upon the exercise of stock options	8,571				8,571
Collections of notes receivable from sale of common stock	6,072				6,072
Borrowings under notes payable and debentures	300,000				300,000
Repayments on notes payable and debentures	(140,000)				(140,000)
Net repayments on revolving line of credit	(204,250)				(204,250)
Other financing activities	(4,727)				(4,727)
Common stock dividends and distributions paid	(264,419)				(264,419)
Preferred stock dividends paid		(200)	(10)		(210)
Net cash provided by (used in) financing activities	123,252	(200)	(10)		123,042
	169,642	17,389	15,950		202,981

Edgar Filing: - Form

Net increase in cash and cash equivalents					
Cash and cash equivalents at beginning of year	<u>1,722</u>	<u>8,926</u>	<u>538</u>	<u>      </u>	<u>11,186</u>
Cash and cash equivalents at end of year	<u>\$ 171,364</u>	<u>\$ 26,315</u>	<u>\$ 16,488</u>	<u>\$</u>	<u>\$ 214,167</u>

F-69

---

**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Shareholders  
Allied Capital Corporation:

We have audited the accompanying consolidated balance sheet of Allied Capital Corporation and subsidiaries as of December 31, 2003 and 2002, including the consolidated statement of investments as of December 31, 2003, and the related consolidated statements of operations, changes in net assets and cash flows, and the financial highlights (included in Note 15), for the years ended December 31, 2003 and 2002. These consolidated financial statements and financial highlights are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial highlights based on our audits. The consolidated financial statements of Allied Capital Corporation and subsidiaries for the year ended December 31, 2001 were audited by other auditors who have ceased operations. Those auditors' report, dated February 20, 2002, on those consolidated financial statements, was unqualified, before the revisions described in Note 2 to the consolidated financial statements, and included an emphasis paragraph that described the Company's method of valuing investments and the inherent uncertainty of valuation as discussed in Note 2 to the consolidated financial statements.

We conducted our audits in accordance with standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and financial highlights are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our procedures included physical counts of securities owned as of December 31, 2003 and 2002. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the 2003 and 2002 consolidated financial statements and financial highlights referred to above present fairly, in all material respects, the financial position of Allied Capital Corporation and subsidiaries as of December 31, 2003 and 2002, the results of their operations, their cash flows, changes in their net assets, and financial highlights for the years then ended, in conformity with U.S. generally accepted accounting principles.

As discussed above, the consolidated financial statements of the Company for the year ended December 31, 2001 were audited by other auditors who have ceased operations. As described in Note 2, those consolidated financial statements have been revised. We audited the revisions described in Note 2 that were applied to the 2001 consolidated financial statements. In our opinion, such revisions are appropriate and have been properly applied. However, we were not engaged to audit, review, or apply any procedures to the 2001 consolidated financial statements of the Company other than with respect to such revisions, and, accordingly, we do not express an opinion or any other form of assurance on the 2001 consolidated financial statements taken as a whole.

Our audits were made for the purpose of forming an opinion on the 2003 and 2002 consolidated financial statements taken as a whole. The consolidating balance sheet and related consolidating statements of operations and cash flows are presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations, and cash flows of the individual companies. The

## Edgar Filing: - Form

consolidating information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

Washington, D.C.

February 17, 2004

F-71

---



**Independent Auditors Report**

*NOTE: THIS IS A COPY OF A REPORT PREVIOUSLY ISSUED BY ARTHUR ANDERSEN LLP, ALLIED CAPITAL CORPORATION S FORMER INDEPENDENT ACCOUNTANTS. THIS REPORT HAS NOT BEEN REISSUED BY ARTHUR ANDERSEN LLP IN CONNECTION WITH FILING OF THE REGISTRATION STATEMENT OF WHICH THIS PROSPECTUS IS A PART.*

**To the Shareholders and Board of Directors of Allied Capital Corporation and Subsidiaries:**

We have audited the accompanying consolidated balance sheets of Allied Capital Corporation and subsidiaries as of December 31, 2001 and 2000, including the consolidated statement of investments as of December 31, 2001, and the related consolidated statements of operations, changes in net assets and cash flows for each of the three years in the period then ended, and the financial highlights (included in Note 15) for the year ended December 31, 2001. These consolidated financial statements, financial highlights and the supplementary consolidating financial information referred to below are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements, financial highlights and the supplementary consolidating financial information referred to below based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and financial highlights are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our procedures included physical counts of investments. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 2, the consolidated financial statements include investments valued at \$2,329,590,000 as of December 31, 2001 and \$1,788,001,000 as of December 31, 2000 (172 percent and 174 percent, respectively, of net assets) whose values have been estimated by the board of directors in the absence of readily ascertainable market values. However, because of the inherent uncertainty of valuation, the board of directors' estimated values 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.

In our opinion, the consolidated financial statements and financial highlights referred to above present fairly, in all material respects, the financial position of Allied Capital Corporation and subsidiaries as of December 31, 2001 and 2000, and the consolidated results of their operations, changes in net assets and cash flows for each of the three years in the period then ended, and the financial highlights for the year ended December 31, 2001 in conformity with accounting principles generally accepted in the United States.

Our audit was made for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The supplementary consolidating balance sheet and related consolidating statements of operations and cash flows are presented for purposes of additional analysis of the consolidated financial statements rather than to present balance sheet, statement of operations and cash flows of the individual companies and are not a

## Edgar Filing: - Form

required part of the consolidated financial statements. This information has been subjected to the auditing procedures applied in our audit of the consolidated financial statements and in our opinion, is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

Vienna, Virginia

February 20, 2002

F-73

---

**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Shareholders

Allied Capital Corporation:

We have reviewed the accompanying consolidated balance sheet of Allied Capital Corporation and subsidiaries, including the consolidated statement of investments, as of June 30, 2004, and the related consolidated statements of operations, the consolidated statements of changes in net assets and cash flows and the financial highlights (included in Note 15) for the six-month periods ended June 30, 2004 and 2003. These consolidated financial statements and financial highlights are the responsibility of the Company's management.

We conducted our reviews in accordance with standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the consolidated financial statements and financial highlights referred to above for them to be in conformity with U.S. generally accepted accounting principles.

Washington, D.C.

August 4, 2004

## PART C

## OTHER INFORMATION

## Item 24. Financial Statements and Exhibits

## 1. Financial Statements.

The following financial statements of Allied Capital Corporation are included in this registration statement in Part A: Information Required in a Prospectus :

	<u>Page</u>
Consolidated Balance Sheet June 30, 2004 (unaudited) and December 31, 2003 and 2002	F-2
Consolidated Statement of Operations For the Six Months Ended June 30, 2004 and 2003 (unaudited) and for the Years Ended December 31, 2003, 2002 and 2001	F-3
Consolidated Statement of Changes in Net Assets For the Six Months Ended June 30, 2004 and 2003 (unaudited) and for the Years Ended December 31, 2003, 2002 and 2001	F-4
Consolidated Statement of Cash Flows For the Six Months Ended June 30, 2004 and 2003 (unaudited) and for the Years Ended December 31, 2003, 2002 and 2001	F-5
Consolidated Statement of Investments June 30, 2004 (unaudited) and December 31, 2003	F-6
Notes to Consolidated Financial Statements	F-29
Report of Independent Registered Public Accounting Firm	F-70
Independent Auditors Report	F-72
Report of Independent Registered Public Accounting Firm	F-74

## 2. Exhibits

<u>Exhibit Number</u>	<u>Description</u>
a.1	Restated Articles of Incorporation. <i>(Incorporated by reference to Exhibit a.1 filed with Allied Capital's Post-Effective Amendment No. 2 to registration statement on Form N-2 (File No. 333-67336) filed on March 22, 2002).</i>
b.	Amended and Restated Bylaws. <i>(Incorporated by reference to Exhibit 3.2 filed with Allied Capital's Form 10-K for the year ended December 31, 2003).</i>
c.	Not applicable.
d.	Specimen Certificate of Allied Capital's Common Stock, par value \$0.0001 per share. <i>(Incorporated by reference to Exhibit d. filed with Allied Capital's registration statement on Form N-2 (File No. 333-51899) filed on May 6, 1998).</i>
e.	Dividend Reinvestment Plan, as amended. <i>(Incorporated by reference to Exhibit e. filed with Allied Capital's registration statement on Form N-2 (File No. 333-87862) filed on May 8, 2002).</i>
f.1	Form of debenture between certain subsidiaries of Allied Capital and the U.S. Small Business Administration. <i>(Incorporated by reference to Exhibit 4.2 filed by a predecessor entity to Allied Capital on Form 10-K for the year ended December 31, 1996).</i>

Edgar Filing: - Form

Exhibit Number	Description
f.2	Third Amended and Restated Credit Agreement, dated April 18, 2003. <i>(Incorporated by reference to Exhibit 10.2 filed with Allied Capital's Form 10-Q for the period ended March 31, 2003).</i>
f.2(a)	First Amendment to Credit Agreement, dated as of October 6, 2003. <i>(Incorporated by reference to Exhibit 10.2(a) filed with Allied Capital's Form 10-Q for the period ended September 30, 2003).</i>
f.2(b)	Second Amendment to Credit Agreement, dated as of December 17, 2003. <i>(Incorporated by reference to Exhibit 10.2(b) filed with Allied Capital's Form 10-K for the year ended December 31, 2003).</i>
f.2(c)	Third Amendment to Credit Agreement, dated May 28, 2004. <i>(Incorporated by reference to Exhibit 10.2(c) filed with Allied Capital's Form 10-Q for the period ended June 30, 2004).</i>
f.3	Note Agreement, dated as of April 30, 1998. <i>(Incorporated by reference to Exhibit 10.2 filed with Allied Capital's Form 10-Q for the period ended June 30, 1998).</i>
f.4	Loan Agreement between a predecessor entity to Allied Capital and Overseas Private Investment Corporation, dated April 10, 1995. <i>(Incorporated by reference to Exhibit f.7 filed by a predecessor entity to Allied Capital to Pre-Effective Amendment No. 2 to the registration statement on Form N-2 (File No. 33-64629) filed on January 24, 1996).</i> Letter, dated December 11, 1997, evidencing assignment of Loan Agreement from the predecessor entity of Allied Capital to Allied Capital. <i>(Incorporated by reference to Exhibit 10.3 of Allied Capital's Form 10-K for the year ended December 31, 1997).</i>
f.5	Note Agreement, dated as of May 1, 1999. <i>(Incorporated by reference to Exhibit 10.5 filed with Allied Capital's Form 10-Q for the period ended June 30, 1999).</i>
f.11	Note Agreement, dated as of November 15, 1999. <i>(Incorporated by reference to Exhibit 10.4a of Allied Capital's Form 10-K for the year ended December 31, 1999).</i>
f.12	Note Agreement, dated as of October 15, 2000. <i>(Incorporated by reference to Exhibit 10.4b filed with Allied Capital's Form 10-Q for the period ended September 30, 2000).</i>
f.13	Note Agreement, dated as of October 15, 2001. <i>(Incorporated by reference to Exhibit f.10 filed with Allied Capital's Post-Effective Amendment No. 1 to registration statement on Form N-2 (File No. 333-67336) filed on November 14, 2001).</i>
f.15	Control Investor Guaranty Agreement, dated as of March 28, 2001, between Allied Capital and Fleet National Bank and Business Loan Express, Inc. <i>(Incorporated by reference to Exhibit f.14 filed with Allied Capital's Post-Effective Amendment No. 3 to registration statement on Form N-2 (File No. 333-43534) filed on May 15, 2001).</i>
f.19	Note Agreement, dated as of May 14, 2003. <i>(Incorporated by reference to Exhibit 10.31 filed with Allied Capital's Form 10-Q for the quarter ended March 31, 2003).</i>
f.20	Amendment, dated as of April 30, 2003, to Note Agreement, dated as of April 30, 1998. <i>(Incorporated by reference to Exhibit 10.32 filed with Allied Capital's Form 10-Q for the period ended March 31, 2003).</i>

Edgar Filing: - Form

Exhibit Number	Description
f.21	Amendment, dated as of April 30, 2003, to Note Agreement, dated as of May 1, 1999. <i>(Incorporated by reference to Exhibit 10.33 filed with Allied Capital's Form 10-Q for the period ended March 31, 2003).</i>
f.22	Amendment, dated as of April 30, 2003, to Note Agreement, dated as of November 15, 1999. <i>(Incorporated by reference to Exhibit 10.34 filed with Allied Capital's Form 10-Q for the period ended March 31, 2003).</i>
f.23	Amendment, dated as of April 30, 2003, to Note Agreement, dated as of October 15, 2000. <i>(Incorporated by reference to Exhibit 10.35 filed with Allied Capital's Form 10-Q for the period ended March 31, 2003).</i>
f.24	Amendment, dated as of April 30, 2003, to Note Agreement, dated as of October 15, 2001. <i>(Incorporated by reference to Exhibit 10.36 filed with Allied Capital's Form 10-Q for the period ended March 31, 2003).</i>
f.25	Note Agreement, dated as of March 25, 2004. <i>(Incorporated by reference to Exhibit 10.38 filed with Allied Capital's Form 10-Q for the period ended March 31, 2004.)</i>
g.	Not applicable.
h.	Form of Underwriting Agreement. <i>(Incorporated by reference to Exhibit h filed with Allied Capital's registration statement on Form N-2 (File No. 333-113671) filed on March 16, 2004).</i>
i.3	Amended and Restated Deferred Compensation Plan, dated January 30, 2004. <i>(Incorporated by reference to Exhibit 10.16 filed with Allied Capital's Form 10-K for the year ended December 31, 2003).</i>
i.4	Amended Stock Option Plan. <i>(Incorporated by reference to Exhibit B of Allied Capital's definitive proxy statement for Allied Capital's 2004 Annual Meeting of Stockholders filed on March 30, 2004).</i>
i.5	Allied Capital Corporation 401(k) Plan, dated September 1, 1999. <i>(Incorporated by reference to Exhibit 4.4 filed with Allied Capital's registration statement on Form S-8 (File No. 333-88681) filed on October 8, 1999).</i>
i.5(a)	Amendment to Allied Capital Corporation 401(k) Plan, dated April 15, 2004. <i>(Incorporated by reference to Exhibit 10.20(b) filed with Allied Capital's Form 10-Q for the period ended June 30, 2004).</i>
i.6	Employment Agreement, dated January 1, 2004, between Allied Capital and William L. Walton. <i>(Incorporated by reference to Exhibit 10.21 filed with Allied Capital's Form 10-K for the year ended December 31, 2003).</i>
i.7	Employment Agreement, dated January 1, 2004, between Allied Capital and Joan M. Sweeney. <i>(Incorporated by reference to Exhibit 10.22 filed with Allied Capital's Form 10-K for the year ended December 31, 2003).</i>
j.1	Form of Custody Agreement with Riggs Bank N.A. <i>(Incorporated by reference to Exhibit j.1 filed with Allied Capital's registration statement on Form N-2 (File No. 333-51899) filed on May 6, 1998).</i>
j.2	Form of Custody Agreement with LaSalle National Bank. <i>(Incorporated by reference to Exhibit j.2 filed with Allied Capital's registration statement on Form N-2 (File No. 333-51899) filed on May 6, 1998).</i>
j.3	Custodian Agreement with LaSalle National Bank Association dated July 9, 2001. <i>(Incorporated by reference to Exhibit j.3 filed with Allied Capital's registration statement on Form N-2 (File No. 333-67336) filed on August 10, 2001).</i>

Exhibit Number	Description
k.1	Agreement and Plan of Merger by and among Allied Capital, Allied Capital Lock Acquisition Corporation, and Sunsource, Inc dated June 18, 2001. <i>(Incorporated by reference to Exhibit k.1 filed with Allied Capital's registration statement on Form N-2 (File No. 333-67336) filed on August 10, 2001).</i>
k.2	Form of Indemnification Agreement between Allied Capital and its directors and certain officers. <i>(Incorporated by reference to Exhibit 10.37 filed with Allied Capital's Form 10-K for the year ended December 31, 2003).</i>
l.	Opinion of counsel and consent to its use. <i>(Incorporated by reference to Exhibit 1 filed with Allied Capital's registration statement on Form N-2 (File No. 333-113671) filed on March 16, 2004).</i>
m.	Not applicable.
n.1	Consent of Sutherland Asbill & Brennan LLP. <i>(Contained in exhibit l).</i>
n.2.a	Consent of Arthur Andersen LLP, <i>(Omitted in reliance on Rule 437a of the Securities Act of 1933).</i>
n.2.b*	Consent of KPMG LLP, independent registered public accounting firm.
n.3.a*	Opinion of KPMG LLP, independent registered public accounting firm, regarding Senior Securities table contained herein.
n.3.b*	Consent of KPMG LLP, independent registered public accounting firm, regarding opinion on Senior Securities table contained herein.
n.3.c*	Letter regarding Unaudited Interim Financial Information.
o.	Not applicable.
p.	Not applicable.
q.	Not applicable.
r.	Code of Ethics. <i>(Incorporated by reference to Exhibit 10.28 filed with Allied Capital's Form 10-K for the year ended December 31, 2003.)</i>

\* Filed herewith.

**Item 25. Marketing Arrangements**

The information contained under the heading Plan of Distribution of the prospectus is incorporated herein by reference, and any information concerning any underwriters will be contained in the accompanying prospectus supplement, if any.

**Item 26. Other Expenses of Issuance and Distribution\***

SEC registration fee	\$ 62,444
NASD filing fee	30,500
New York Stock Exchange Additional Listing Fee	70,000
Accounting fees and expenses	350,000
Legal fees and expenses	500,000
Printing and engraving	335,000
Miscellaneous fees and expenses	2,056
	<hr/>
Total	\$1,350,000
	<hr/>

\* Estimated for filing purposes and excludes fees previously paid.

All of the expenses set forth above shall be borne by us.

**Item 27. Persons Controlled by or Under Common Control**

*Direct Subsidiaries*

The following list sets forth each of our subsidiaries, the state or country under whose laws the subsidiary is organized, and the percentage of voting securities or membership interests owned by us in such subsidiary:

Allied Investment Corporation (Maryland)	100%
Allied Capital REIT, Inc. ( Allied REIT ) (Maryland)	100%
A.C. Corporation (Delaware)	100%
Allied Capital Holdings, LLC (Delaware)	100%
Allied Capital Beteiligungsberatung GmbH (Germany) (inactive)	100%

Each of our subsidiaries is consolidated for financial reporting purposes, except as noted below.

*Indirect Subsidiaries*

We indirectly control the entities set forth below through Allied REIT. Allied REIT owns either all of the membership interests (in the case of a limited liability company, LLC ) or all of the outstanding voting stock (in the case of a corporation) of each entity. The following list sets forth each of Allied REIT's subsidiaries, the state under whose laws the subsidiary is organized, and the percentage of voting securities or membership interests owned by Allied REIT of such subsidiary:

Allied Capital Property LLC (Delaware)	100%
Allied Capital Equity LLC (Delaware)	100%
9586 I-25 East Frontage Road, Longmont, CO 80504 LLC (Delaware)	100%

We indirectly control Allied Investment Holdings LLC (Delaware) through Allied Investment Corporation, which owns 100% of the membership interests. We indirectly control AC Management Services, Inc. (Delaware) through A.C. Corporation, which owns 100% of the common stock. We indirectly control Allied Capital Investors, LLC (Delaware) through A.C. Corporation, which is the sole member and manager.

*Other Entities Deemed to be Controlled by the Company*

We have also established certain limited purpose entities in order to facilitate certain portfolio transactions. In addition, we may be deemed to control certain portfolio companies. See Portfolio Companies in the prospectus.



**Item 28. Number of Holders of Securities**

The following table sets forth the approximate number of record holders of our common stock at September 14, 2004.

Title of Class	Number of Record Holders
Common stock, \$0.0001 par value	5,400

We have privately issued long-term debt securities to 23 institutional lenders, primarily insurance companies.

**Item 29. Indemnification**

Section 2-418 of the Maryland General Corporation Law provides that a Maryland corporation may indemnify any director of the corporation and any person who, while a director of the corporation, is or was serving at the request of the corporation as a director, officer, partner, trustee, employee, or agent of another foreign or domestic corporation, partnership, joint venture, trust, other enterprise or employee benefit plan, made a party to any proceeding by reason of service in that capacity unless it is established that the act or omission of the director was material to the matter giving rise to the proceeding and was committed in bad faith or was the result of active and deliberate dishonesty; or the director actually received an improper personal benefit in money, property or services; or, in the case of any criminal proceeding, the director had reasonable cause to believe that the act or omission was unlawful. Indemnification may be made against judgments, penalties, fines, settlements, and reasonable expenses actually incurred by the director in connection with the proceeding, but if the proceeding was one by or in the right of the corporation, indemnification may not be made in respect of any proceeding in which the director shall have been adjudged to be liable to the corporation. Such indemnification may not be made unless authorized for a specific proceeding after a determination has been made, in the manner prescribed by the law, that indemnification is permissible in the circumstances because the director has met the applicable standard of conduct. On the other hand, the director must be indemnified for expenses if he or she has been successful in the defense of the proceeding or as otherwise ordered by a court. The law also prescribes the circumstances under which the corporation may advance expenses to, or obtain insurance or similar cover for, directors.

The law also provides for comparable indemnification for corporate officers and agents.

The Restated Articles of Incorporation of Allied Capital provide that its directors and officers shall, and its agents in the discretion of the board of directors may be indemnified to the fullest extent permitted from time to time by the laws of Maryland (with such power to indemnify officers and directors limited to the scope provided for in Section 2-418 as currently in force), provided, however, that such indemnification is limited by the Investment Company Act of 1940 or by any valid rule, regulation or order of the Securities and Exchange Commission thereunder. Allied Capital's bylaws, however, provide that Allied Capital may not indemnify any director or officer against liability to Allied Capital or its security holders to which he or she might otherwise be subject by reason of such person's willful misfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of his or her office unless a determination is made by final decision of a court, by vote of a majority of a quorum of directors who are disinterested, non-party directors or by independent legal counsel that the liability for which indemnification is sought did not arise out of such disabling conduct.

## Edgar Filing: - Form

Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers and controlling persons of Allied Capital pursuant to the provisions described above, or otherwise, Allied Capital has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by Allied Capital of expenses incurred or paid by a director, officer or controlling person in the successful defense of an action, suit or proceeding) is asserted by a director, officer or controlling person in connection with the securities being registered, Allied Capital will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Act and will be governed by the final adjudication of the court of the issue.

Allied Capital carries liability insurance for the benefit of its directors and officers on a claims-made basis of up to \$50,000,000, subject to a \$1,000,000 retention and the other terms thereof. Allied Capital also maintains an additional \$10,000,000 of insurance coverage for the benefit of its directors and officers.

As of August 31, 2004, we have entered into indemnification agreements with our directors and 11 senior officers. The indemnification agreements attempt to provide these directors and senior officers the maximum indemnification permitted under Maryland law and the Investment Company Act of 1940. Each indemnification agreement provides that Allied Capital shall indemnify the director or senior officer who is a party to the agreement (an Indemnitee ) if, by reason of his corporate status, the Indemnitee is, or is threatened to be, made a party to or a witness in any threatened, pending, or completed proceeding, other than a proceeding by or in the right of Allied Capital.

At present, there is no pending litigation or proceeding involving an Indemnitee where indemnification would be required or permitted under the indemnification agreement.

### **Item 30. Business and Other Connections of Investment Adviser**

Not applicable.

### **Item 31. Location of Accounts and Records**

We maintain at our principal office physical possession of each account, book or other document required to be maintained by Section 31(a) of the 1940 Act and the rules thereunder.

### **Item 32. Management Services**

Not applicable.

### **Item 33. Undertakings**

We hereby undertake:

(1) to suspend the offering of shares until the prospectus is amended if subsequent to the effective date of this registration statement, our net asset value declines more than ten percent from our net asset value as of the effective date of this registration statement or (2) our net asset value increases to an amount greater than our net proceeds as stated in the prospectus;

C-7

---

## Edgar Filing: - Form

(2) to file, during any period in which offers or sales are being made, a post-effective amendment to this registration statement:

- (i) to include any prospectus required by Section 10(a)(3) of the Securities Act of 1933;
- (ii) to reflect in the prospectus any facts or events arising after the effective date of the registration statement (or the most recent post-effective amendment thereof) which, individually or in the aggregate, represent a fundamental change in the information set forth in the registration statement. Notwithstanding the foregoing, any increase or decrease in volume of securities offered (if the total dollar value of securities offered would not exceed that which was registered) and any deviation from the low or high end of the estimated maximum offering range may be reflected in the form of prospectus filed with the SEC pursuant to Rule 424(b) under the Securities Act of 1933 if, in the aggregate, the changes in volume and price represent no more than a 20% change in the maximum aggregate offering price set forth in the Calculation of Registration Fee table in the effective registration statement; and
- (iii) to include any material information with respect to the plan of distribution not previously disclosed in the registration statement or any material change to such information in the registration statement.

(3) that, for the purpose of determining any liability under the Securities Act of 1933, the information omitted from the form of prospectus filed as part of this registration statement in reliance upon Rule 430A and contained in a form of prospectus filed by us under Rule 497(h) under the Securities Act of 1933 shall be deemed to be part of this registration statement as of the time it was declared effective;

(4) to remove from registration by means of a post-effective amendment any of the securities being registered which remain unsold at the termination of the offering; and

(5) that, for the purpose of determining any liability under the Securities Act of 1933, each post effective amendment that contains a form of prospectus shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of the securities at that time shall be deemed to be the initial bona fide offering thereof.

C-8

---

Edgar Filing: - Form

**SIGNATURES**

Pursuant to the requirements of the Securities Act of 1933, the Registrant has duly caused this registration statement to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Washington, in the District of Columbia, on the 14th day of September, 2004.

ALLIED CAPITAL CORPORATION

By: /s/ WILLIAM L. WALTON

---

William L. Walton,  
Chairman of the Board, Chief  
Executive Officer and President

Pursuant to the requirements of the Securities Act of 1933, this Registration Statement has been signed by the following persons in the capacities indicated on September 14, 2004.

<b>Signature</b>	<b>Title</b>
<hr/> /s/ WILLIAM L. WALTON <hr/>	<hr/> Chairman of the Board, Chief Executive Officer, and President <hr/>
William L. Walton	
*	Director
<hr/> Brooks H. Browne <hr/>	
*	Director
<hr/> John D. Firestone <hr/>	
*	Director
<hr/> Anthony T. Garcia <hr/>	
*	Director
<hr/> Ann Torre Grant <hr/>	
*	Director
<hr/> Lawrence I. Hebert <hr/>	
*	Director
<hr/> John I. Leahy <hr/>	
*	Director
<hr/> Robert E. Long <hr/>	
*	Director
<hr/> Alex J. Pollock <hr/>	
*	Director

Edgar Filing: - Form

---

Guy T. Steuart II

/s/ JOAN M. SWEENEY

Director

---

Joan M. Sweeney

---

Edgar Filing: - Form

**Signature**

**Title**

\*

Director

Laura W. van Roijen

/s/ PENNI F. ROLL

Chief Financial Officer  
(Principal Financial and Accounting Officer)

Penni F. Roll

\* Signed by Joan M. Sweeney pursuant to a power of attorney signed by each individual and filed with this registration statement on March 16, 2004.

**INDEX TO EXHIBITS**

<b>Exhibit Number</b>	<b>Description</b>
Ex - 99.n.2.b	Consent of KPMG LLP, independent registered public accounting firm.
Ex - 99.n.3.a	Opinion of KPMG LLP, independent registered public accounting firm, regarding Senior Securities table contained herein.
Ex - 99.n.3.b	Consent of KPMG LLP, independent registered public accounting firm, regarding opinion on Senior Securities table contained herein.
Ex - 99.n.3.c	Letter regarding Unaudited Interim Financial Information.