ALLIED CAPITAL CORP
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PROSPECTUS SUPPLEMENT
(To Prospectus dated April 27, 2006)

40,000,000 Shares

This prospectus supplement supplements the prospectus dated April 27, 2006, relating to our offer, from time to time, of up to 40,000,000 shares of our common stock by providing certain information regarding our recent developments and our third quarter 2006 financial results. As of the date of this prospectus supplement, we have sold 5,175,000 shares of the 40,000,000 shares of our common stock.

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

You should review the information, including the risk of leverage, set forth under Risk Factors on page 10 of the accompanying prospectus before investing.

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

The date of this prospectus supplement is November 20, 2006

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

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Prospectus Supplement

ABOUT THIS PROSPECTUS

This prospectus is part of a registration statement that we have filed with the Securities and Exchange Commission using the shelf registration process. Under the shelf registration process, we may offer, from time to time, up to 40,000,000 shares of our common stock on the terms to be determined at the time of the offering. Shares of our common stock may be offered at prices and on terms described in one or more supplements to this prospectus. This prospectus provides you with a general description of the shares of our common stock that we may offer. Each time we use this prospectus to offer shares of our common stock, we will provide a prospectus supplement that will contain specific information about the terms of that offering. A prospectus supplement may also add, update or change information contained in this prospectus. Please carefully read this prospectus and any such supplements together with the additional information described under Where You Can Find Additional Information in the Prospectus Summary and Risk Factors sections before you make an investment decision.

INTERIM MANAGEMENT S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following analysis of the financial condition and results of operations of the Company should be read in conjunction with the Company s Consolidated Financial Statements and the Notes thereto included herein and in the Company s annual report on Form 10-K for the year ended December 31, 2005. In addition, this quarterly report on Form 10-Q contains certain forward-looking statements. These statements include the plans and objectives of management for future operations and financial objectives and can be identified by the use of forward-looking terminology such as may, will, expect, intend, anticipate, estimate, or continue or the negative thereof or o variations thereon or comparable terminology. These forward-looking statements are subject to the inherent uncertainties in predicting future results and conditions. Certain factors that could cause actual results and conditions to differ materially from those projected in these forward-looking statements are set forth below in the Risk Factors section. Other factors that could cause actual results to differ materially include:

changes in the economy and general economic conditions;

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

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

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

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

OVERVIEW

As a business development company, we are in the private equity business. Specifically, we provide long-term debt and equity investment capital to companies in a variety of industries. Our lending and investment activity has generally been focused on private finance and commercial real estate finance, which included primarily the investment in non-investment grade commercial mortgage-backed securities, which we refer to as CMBS, and collateralized debt obligation bonds and preferred shares, which we refer to as CDOs.

On May 3, 2005, we completed the sale of our portfolio of CMBS and real estate related CDO investments. Upon the completion of this transaction, our lending and investment activity has been focused primarily on private finance investments. Our private finance activity principally involves providing financing to middle market U.S. companies through privately negotiated long-term debt and equity investment capital. Our financing is generally used to fund growth, acquisitions, buyouts, recapitalizations, note purchases, bridge financings, and other types of financings. We generally invest in private companies though, from time to time, we may invest in companies that are public but lack access to additional public capital. Our investment objective is to achieve current income and capital gains.

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Our portfolio composition at September 30, 2006 and 2005, and at December 31, 2005, was as follows:

	September 30, 2006	September 30, 2005	December 31, 2005
Private finance	97%	96%	96%
Commercial real estate finance	3%	4%	4%

Our earnings depend primarily on the level of interest and dividend income, fee and other income, and net realized and unrealized gains or losses on our investment portfolio after deducting interest expense on borrowed capital, operating expenses and income taxes including excise tax. Interest income results from the stated interest rate earned on a loan or debt security and the amortization of loan origination fees and discounts. The level of interest income is directly related to the balance of the interest-bearing investment portfolio outstanding during the period multiplied by the weighted average yield. Our ability to generate interest income is dependent on economic, regulatory, and competitive factors that influence new investment activity, interest rates on the types of loans we make, the level of repayments in the portfolio, the amount of loans and debt securities for which interest is not accruing and our ability to secure debt and equity capital for our investment activities.

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

PORTFOLIO AND INVESTMENT ACTIVITY

The total portfolio at value, investment activity, and the yield on interest-bearing investments at and for the three and nine months ended September 30, 2006 and 2005, and at and for the year ended December 31, 2005, were as follows:

($ in millions)	At and for the Three Months Ended September 30, 2006	At and for the Three Months Ended September 30, 2005	At and for the Nine Months Ended September 30, 2006	At and for the Nine Months Ended September 30, 2005	At and for the Year Ended December 31, 2005
Portfolio at value	$ 4,119.6	$ 3,223.8	$ 4,119.6	$ 3,223.8	$ 3,606.4
Investments funded[1]	$ 629.5	$ 673.4	$ 1,880.8	$ 1,328.2	$ 1,675.8
Change in accrued or reinvested interest and dividends[2]	$ 7.2	$ 5.5	$ (1.8)	$ 1.9	$ 6.6
Principal collections related to investment repayments or sales	$ 116.3	$ 151.0	$ 885.9	$ 1,241.8	$ 1,503.4
Yield on interest-bearing investments[3]	12.3%	12.6%	12.3%	12.6%	12.8%

(1) Investments funded for the nine months ended September 30, 2006, included a $150 million subordinated debt investment in Advantage Sales & Marketing, Inc. received in conjunction with the sale of Advantage and a $30 million subordinated debt investment in STS Operating, Inc. received in conjunction with the sale of STS. See discussion below. Investments funded also include investments acquired through the issuance of our common stock as consideration totaling zero and $7.2 million for the nine months ended September 30, 2006 and 2005, respectively, and $7.2 million for the year ended December 31, 2005.

(2)

Includes changes in accrued or reinvested interest of $1.3 million and $3.0 million for the three and nine months ended September 30, 2006, respectively, related to our investments in money market securities.

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

Private Finance

The private finance portfolio at value, investment activity, and the yield on loans and debt securities at and for the three and nine months ended September 30, 2006 and 2005, and at and for the year ended December 31, 2005, were as follows:

	At and for the Three Months Ended September 30,				At and for the Nine Months Ended September 30,				At and for the Year Ended December 31,	
	2006		2005		2006		2005		2005	
millions)	Value	Yield(2)	Value	Yield(2)	Value	Yield(2)	Value	Yield(2)	Value	Yiel
olio at value:										
s and debt ities:										
r loans	$ 342.4	8.7%	$ 255.9	8.6%	$ 342.4	8.7%	$ 255.9	8.6%	$ 239.8	9
anche debt	745.8	11.2%	197.2	11.8%	745.8	11.2%	197.2	11.8%	294.2	11
rdinated debt	1,817.0	13.7%	1,586.5	13.8%	1,817.0	13.7%	1,586.5	13.8%	1,560.9	13
loans and debt ities	$ 2,905.2	12.5%	$ 2,039.6	13.0%	$ 2,905.2	12.5%	$ 2,039.6	13.0%	$ 2,094.9	13
y securities	1,082.6		1,041.4		1,082.6		1,041.4		1,384.4	
portfolio	$ 3,987.8		$ 3,081.0		$ 3,987.8		$ 3,081.0		$ 3,479.3	
tments funded(1)	$ 629.2		$ 665.7		$ 1,866.6		$ 1,131.9		$ 1,462.3	
ge in accrued or ested interest and ends	$ 5.8		$ 5.9		$ (5.4)		$ 20.4		$ 24.6	
ipal collections d to investment ments or sales	$ 115.6		$ 146.5		$ 868.0		$ 476.5		$ 703.9	

(1) Investments funded for the nine months ended September 30, 2006, included a $150 million subordinated debt investment in Advantage Sales & Marketing, Inc. received in conjunction with the sale of Advantage and a $30 million subordinated debt investment in STS Operating, Inc. received in conjunction with the sale of STS. See discussion below.

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

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

In addition, we may fund most or all of the debt and equity capital upon the closing of certain buyout transactions, which may include investments in lower-yielding senior debt. Subsequent to the closing, the portfolio company may refinance all or a portion of the lower-yielding senior debt, which would reduce our investment. Repayments include repayments of senior debt funded by us that was subsequently refinanced or repaid by the portfolio companies.

We intend to take a balanced approach to private equity investing that emphasizes a complementary mix of debt investments and buyout investments. The combination of these two types of investments provides current interest and related portfolio income and the potential for future capital gains. To address the current market, our strategy is to focus on buyout and recapitalization transactions where we can manage risk through the structure and terms of our debt and equity investments and where we can potentially realize more attractive total returns from both current interest and fee income and future capital gains. We are also focusing our debt investing on smaller middle market companies where we can provide both senior and subordinated debt or unitranche debt, where our combined current yield may be lower than traditional subordinated debt only. We believe that providing both senior and subordinated debt or unitranche debt provides us with greater protection in the capital structures of our portfolio companies.

Investments Funded. Investments funded and the weighted average yield on investments funded for the nine months ended September 30, 2006 and 2005, and for the year ended December 31, 2005, consisted of the following:

	For the Nine Months Ended September 30, 2006					
	Debt Investments		Buyout Investments		Total	
($ in millions)	**Amount**	**Weighted Average Yield(1)**	**Amount**	**Weighted Average Yield(1)**	**Amount**	**Weighted Average Yield(1)**
Loans and debt securities:						
Senior loans(4)	$ 202.4	9.4%	$ 167.3	8.8%	$ 369.7	9.1%
Unitranche debt(2)	348.7	10.6%	146.5	12.9%	495.2	11.3%
Subordinated debt(3)	508.0	13.1%	250.8	13.9%	758.8	13.3%
Total loans and debt securities	1,059.1	11.5%	564.6	12.1%	1,623.7	11.8%
Equity	62.9		180.0		242.9	
Total	$ 1,122.0		$ 744.6		$ 1,866.6	

	For the Nine Months Ended September 30, 2005					
	Debt Investments		Buyout Investments		Total	
($ in millions)	**Amount**	**Weighted Average Yield(1)**	**Amount**	**Weighted Average Yield(1)**	**Amount**	**Weighted Average Yield(1)**
Loans and debt securities:						
Senior loans	$ 50.7	10.6%	$ 186.8	6.0%	$ 237.5	7.0%
Unitranche debt(2)	154.9	10.5%			154.9	10.5%
Subordinated debt	239.0	12.6%	313.9	12.6%	552.9	12.6%
Total loans and debt securities	444.6	11.7%	500.7	10.2%	945.3	10.9%
Equity	23.9		162.7		186.6	
Total	$ 468.5		$ 663.4		$ 1,131.9	

(1) The weighted average yield on loans and debt securities is computed as the (a) annual stated interest on accruing loans and debt securities, divided by (b) total loans and debt securities funded.

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

(3) Debt investments for the nine months ended September 30, 2006, included a $150 million, 12.0% subordinated debt investment in Advantage Sales & Marketing, Inc. received in conjunction with the sale of Advantage and a $30 million, 15.0% subordinated debt investment in STS Operating, Inc. received in conjunction with the sale of STS. See discussion below.

(4)

Senior loans funded for the nine months ended September 30, 2006, included $192.2 million that was repaid during the nine months ended September 30, 2006.

	For the Year Ended December 31, 2005					
	Debt Investments		Buyout Investments		Total	
($ in millions)	Amount	Weighted Average Yield[1]	Amount	Weighted Average Yield[1]	Amount	Weighted Average Yield[1]
Loans and debt securities:						
Senior loans[3]	$ 76.8	10.0%	$ 250.2	6.4%	$ 327.0	7.2%
Unitranche debt[2]	259.5	10.5%			259.5	10.5%
Subordinated debt	296.9	12.3%	330.9	12.5%	627.8	12.4%
Total loans and debt securities	633.2	11.3%	581.1	9.9%	1,214.3	10.6%
Equity	82.5		165.5		248.0	
Total	$ 715.7		$ 746.6		$ 1,462.3	

(1) The weighted average yield on loans and debt securities is computed as the (a) annual stated interest on accruing loans and debt securities, divided by (b) total loans and debt securities funded.

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

(3) Buyout senior loans funded included $174.9 million that was repaid during 2005 and $14.1 million that was repaid during the nine months ended September 30, 2006.

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

The level of investment activity for investments funded and principal repayments for private finance investments can vary substantially from period to period depending on the number and size of investments that we make or that we exit and many other factors, including the amount of debt and equity capital available to middle market companies, the level of merger and acquisition activity for such companies, the general economic environment, and the competitive environment for the types of investments we make. We believe that merger and acquisition activity in the middle market is strong, which has resulted in an increase in private finance investment opportunities, as well as increased repayments. We continue to have an active pipeline of new investments under consideration. We believe that merger and acquisition activity for middle market companies will remain strong for the remainder of 2006 and into 2007.

Through our wholly owned subsidiary, AC Finance LLC (AC Finance), we generally originate, underwrite and arrange senior loans. Senior loans originated and underwritten by AC Finance may or may not be funded by us at closing. When these senior loans are closed, we may fund all or a portion of the underwritten commitment pending sale of the loan to other investors, which may include loan sales to Callidus Capital Corporation (Callidus) or funds managed by Callidus, a portfolio company controlled by us. After completion of the sale process, we may or may not retain a position in these senior loans. AC Finance generally earns a fee on the senior loans originated and underwritten whether or not we fund the underwritten commitment.

Yield. The weighted average yield on private finance loans and debt securities was 12.5% at September 30, 2006, as compared to 13.0% at both September 30, 2005 and December 31, 2005. The weighted average yield on the private finance loans and debt securities may fluctuate from period to period, depending on the yield on new loans and debt securities funded, the yield on loans and debt securities repaid, the amount of loans and debt securities for which interest is not accruing (see Portfolio Asset Quality Loans and Debt Securities on Non-Accrual Status below) and the amount of lower-yielding senior or unitranche debt in the portfolio at the end of the period. The yield on the private finance portfolio has declined partly due to our strategy to pursue investments where our position in the portfolio company capital structure is more senior, such as senior debt and unitranche investments. These investments typically have lower yields than subordinated debt investments.

Outstanding Investment Commitments. At September 30, 2006, we had outstanding private finance investment commitments as follows:

($ in millions)	Companies More Than 25% Owned[1]	Companies 5% to 25% Owned	Companies Less Than 5% Owned	Total
Senior loans	$ 19.6	$ 12.6	$ 93.3	$ 125.5[2]
Unitranche debt			85.8	85.8
Subordinated debt	36.6	3.1	6.8	46.5
Total loans and debt securities	56.2	15.7	185.9	257.8
Equity securities	86.7	11.7	43.3	141.7[3]
Total	$ 142.9	$ 27.4	$ 229.2	$ 399.5

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

($ in millions)	Committed Amount	Amount Drawn	Amount Available to be Drawn
Subordinated debt to support warehouse facilities & warehousing activities[*]	$ 36.0	$	$ 36.0
Revolving line of credit for working capital	4.0		4.0
Purchase of preferred equity in future CLO transactions	77.0		77.0
Total	$ 117.0	$	$ 117.0

(*) Callidus has a secured warehouse credit facility with a third party for up to $240 million. The facility is used primarily to finance the acquisition of loans pending securitization through a CDO or CLO. In conjunction with this warehouse credit facility, we have agreed to designate our $36 million subordinated debt commitment for Callidus to draw upon to provide first loss capital as needed to support the warehouse facility.

(2) Includes $114.3 million in the form of revolving senior debt facilities to 22 companies.

(3) Includes $55.0 million to 16 private equity and venture capital funds, including $5.9 million in co-investment commitments to Pine Creek Equity Partners, LLC.

In addition to these outstanding investment commitments at September 30, 2006, we may be required to fund additional amounts under earn-out arrangements primarily related to buyout transactions in the future if those companies meet agreed-upon performance targets. We also had commitments to private finance portfolio companies in the form of standby letters of credit and guarantees totaling $240.5 million. See Financial Condition, Liquidity and Capital Resources.

Our largest investment at value at September 30, 2006, was in Business Loan Express, LLC (BLX) and our largest investments at value at December 31, 2005, were in Advantage Sales & Marketing, Inc. (Advantage) and BLX.

Business Loan Express, LLC. At September 30, 2006, our investment in BLX totaled $295.1 million at cost and $284.9 million at value, or 6.2% of our total assets, which included unrealized depreciation of $10.2 million. We acquired BLX in 2000.

Total interest and related portfolio income earned from the Company s investment in BLX for the nine months ended September 30, 2006 and 2005, was as follows:

($ in millions)	**2006**	**2005**
Interest income	$ 11.9	$ 10.5
Dividend income		9.0
Fees and other income	6.3	7.0
Total interest and related portfolio income	$ 18.2	$ 26.5

Interest income from BLX for the nine months ended September 30, 2006 and 2005, included interest income of $5.7 million and $5.1 million, respectively, which was paid in kind. The interest paid in kind was paid to us through the issuance of additional Class A equity interests. Accrued interest and dividends receivable at September 30, 2006, included accrued interest due from BLX totaling $1.2 million, of which $0.7 million was paid in cash in October 2006.

Net change in unrealized appreciation or depreciation included a net decrease on our investment in BLX of $67.9 million for the nine months ended September 30, 2006, and a net increase on our investment in BLX of $15.9 million for the nine months ended September 30, 2005. See Results of Operations for a discussion of the net change in unrealized appreciation or depreciation related to this investment.

BLX is a national, non-bank lender that participates in the SBA s 7(a) Guaranteed Loan Program and is licensed by the SBA as a Small Business Lending Company (SBLC). BLX is a preferred lender, as designated by the SBA, and originates, sells, and services small business loans. In addition, BLX originates conventional small business loans and small investment real estate loans. BLX has offices across the United States and is headquartered in New York, New York. Changes in the laws or regulations that govern SBLCs or the SBA 7(a) Guaranteed Loan Program or changes in government funding for this program could have a material adverse impact on BLX and, as a result, could negatively affect our financial results.

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. We hold 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 C interests. BLX may declare dividends on its Class B interests. If declared, BLX would determine the amount of such dividend considering its estimated annual taxable income allocable to such interests.

At December 31, 2005, BLX had a three-year $275.0 million revolving credit facility provided by third party lenders that was scheduled to mature in January 2007. As the controlling equity owner in BLX, we had provided an unconditional guaranty to the revolving credit facility lenders in an amount equal to 50% of the total obligations (consisting of principal, letters of credit issued under the facility, accrued interest, and other fees) of BLX under the revolving credit facility. At December 31, 2005, the principal amount of loans outstanding on the revolving credit facility was $228.2 million and letters of credit issued under the facility were $41.7 million. The total obligation guaranteed by us at December 31, 2005, was $135.4 million.

On March 17, 2006, BLX closed on a new three-year $500.0 million revolving credit facility that matures in March 2009, which replaced the existing facility. The revolving credit facility may be expanded through new or additional commitments up to $600.0 million at BLX s option. This new facility provides for a sub-facility for the issuance of letters of credit for up to an amount equal to 25% of the committed facility. We have provided an unconditional guaranty to these revolving credit facility lenders in an amount equal to 50% of the total obligations (consisting of principal, letters of credit issued under the facility, accrued interest, and other fees) of BLX under this facility. At September 30, 2006, the principal amount outstanding on the revolving credit facility was $319.9 million and letters of credit issued under the facility were $55.9 million. The total obligation guaranteed by us at September 30, 2006, was $188.1 million. This guaranty can be called by the lenders only in the event of a default under the BLX credit facility, which includes certain defaults under our revolving credit facility. BLX has determined it was in compliance with the terms of this facility at September 30, 2006.

At September 30, 2006, we had also provided four standby letters of credit totaling $29.5 million in connection with four term securitization transactions completed by BLX. In consideration for providing the revolving credit facility guaranty and the standby letters of credit, BLX paid us fees of $4.6 million and $4.7 million for the nine months ended September 30, 2006 and 2005, respectively, which were included in fees and other income above.

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

On March 29, 2006, we sold our majority equity interest in Advantage. We were repaid our $184 million in subordinated debt outstanding and realized a gain at closing on our equity investment sold of $433.1 million, subject to post-closing adjustments. As consideration for the common stock sold in the transaction, we received a $150 million subordinated note, with the balance of the consideration paid in cash. Approximately $34 million of our cash proceeds from the sale of the common stock were placed in escrow at closing, subject to certain holdback provisions. In the second and third quarters of 2006, we realized additional gains resulting from post-closing adjustments totaling $1.3 million. In addition, there is potential for us to receive additional consideration through an earn-out payment that would be based on Advantage s 2006 audited results. Our realized gain of $434.4 million as of September 30, 2006, subject to post-closing adjustments, excludes any earn-out amounts. For tax purposes, the receipt of the $150 million subordinated note as part of our consideration for the common stock sold will allow us, through installment treatment, to defer the recognition of taxable income for a portion of our realized gain until the note is collected. In connection with the transaction, we retained an equity investment in the business valued at $15 million at closing as a minority shareholder.

Total interest and related portfolio income earned from our investment in Advantage while we held a majority equity interest was $14.1 million, which included a prepayment premium of $5.0 million, for the nine months ended September 30, 2006, and $28.2 million for the nine months ended September 30, 2005. In addition, we earned structuring fees of $2.3 million on our new $150 million subordinated debt investment in Advantage upon the closing of the sale transaction.

Our investment in Advantage at September 30, 2006, which was composed of subordinated debt and a minority equity interest, totaled $152.9 million at cost and $163.9 million at value, which included unrealized appreciation of $11.0 million. Subsequent to the completion of the sale transaction, our interest income from our subordinated debt investment in Advantage for the three and nine months ended September 30, 2006, was $4.6 million and $9.4 million, respectively.

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

Commercial Real Estate Finance

The commercial real estate finance portfolio at value, investment activity, and the yield on interest-bearing investments at and for the three and nine months ended September 30, 2006 and 2005, and at and for the year ended December 31, 2005, were as follows:

	At and for the Three Months Ended September 30,				At and for the Nine Months Ended September 30,				At and for the Year Ended December 31,	
	2006		2005		2006		2005		2005	
($ in millions)	**Value**	**Yield[1]**	**Value**	**Yield[1]**	**Value**	**Yield[1]**	**Value**	**Yield[1]**	**Value**	**Yield[1]**
Portfolio at value:										
Commercial mortgage loans	$ 94.4	7.7%	121.2	6.6%	$ 94.4	7.7%	121.2	6.6%	102.6	7.6%
Real estate owned	15.3		15.1		15.3		15.1		13.9	
Equity interests	22.1		6.5		22.1		6.5		10.6	
Total portfolio	$ 131.8		$ 142.8		$ 131.8		$ 142.8		$ 127.1	
Investments funded	$ 0.3		$ 7.7		$ 14.2		$ 196.3		$ 213.5	
Change in accrued or reinvested interest	$ 0.1		$ (0.4)		$ 0.6		$ (18.5)		$ (18.0)	
Principal collections related to investment repayments or sales[2]	$ 0.7		$ 4.5		$ 17.9		$ 765.3		$ 799.5	

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

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

Our commercial real estate investments funded for the nine months ended September 30, 2006 and 2005, and for the year ended December 31, 2005, were as follows:

($ in millions)	**Face Amount**	**Discount**	**Amount Funded**
For the Nine Months Ended September 30, 2006			
Commercial mortgage loans	$ 7.7	$	$ 7.7
Equity interests	6.5		6.5
Total	$ 14.2	$	$ 14.2

For the Nine Months Ended September 30, 2005						
CMBS bonds (4 new issuances)[(1)]	$	211.5	$	(90.5)	$	121.0
Commercial mortgage loans		73.5		(0.9)		72.6
Equity interests		2.7				2.7
Total	$	287.7	$	(91.4)	$	196.3
For the Year Ended December 31, 2005						
CMBS bonds (4 new issuances)[(1)]	$	211.5	$	(90.5)	$	121.0
Commercial mortgage loans		88.5		(0.8)		87.7
Equity interests		4.8				4.8
Total	$	304.8	$	(91.3)	$	213.5

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

At September 30, 2006, we had outstanding funding commitments related to commercial mortgage loans and equity interests of $9.1 million and commitments in the form of standby letters of credit and guarantees related to equity interests of $6.9 million.

Sale of CMBS Bonds and Collateralized Debt Obligation Bonds and Preferred Shares. On May 3, 2005, we completed the sale of our portfolio of commercial mortgage-backed securities (CMBS) and real estate related collateralized debt obligation (CDO) bonds and preferred shares to affiliates of Caisse de dépôt et placement du Québec (the Caisse) for cash proceeds of $976.0 million and a net realized gain of $227.7 million, after transaction and other costs of $7.8 million. Transaction costs included investment banking fees, legal and other professional fees, and other transaction costs. The CMBS and CDO assets sold had a cost basis at closing of $739.8 million, including accrued interest of $21.7 million. Upon the closing of the sale, we settled all the hedge positions relating to these assets, which resulted in a net realized loss of $0.7 million, which was included in the net realized gain on the sale.

Simultaneous with the sale of our CMBS and CDO portfolio, we entered into a platform assets purchase agreement with CWCapital Investments LLC, an affiliate of the Caisse (CWCapital), pursuant to which we agreed to sell certain commercial real estate related assets, including servicer advances, intellectual property, software and other platform assets, subject to certain adjustments. Under this agreement, we have agreed not to invest in CMBS and real estate-related CDOs and refrain from certain other real estate-related investing or servicing activities for a period of three years, or through May 2008, subject to certain limitations and excluding our existing portfolio and related activities.

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

Hedging Activities

We have invested in commercial mortgage loans, which were purchased at prices that were based in part on comparable Treasury rates. We have entered into transactions with one or more financial institutions to hedge against movement in Treasury rates on certain of these commercial mortgage loans. These transactions, referred to as short sales, involve 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, whatever that price may be. Risks in these contracts arise from movements in the value of the borrowed Treasury securities due to changes in interest rates and from the possible inability of counterparties to meet the terms of their contracts. If the value of the borrowed Treasury securities increases, we will incur losses on these transactions. These losses are limited to the increase in value of the borrowed Treasury securities; conversely, the value of the hedged commercial mortgage loans would likely increase. If the value of the borrowed Treasury securities decreases, we will incur gains on these transactions which are limited to the decline in value of the borrowed Treasury securities; conversely, the value of the hedged commercial mortgage loans would likely decrease. We do not anticipate nonperformance by any counterparty in connection with these transactions.

The total obligations to replenish borrowed Treasury securities, including accrued interest payable on the obligations, were $17.7 million at both September 30, 2006, and December 31, 2005. The net proceeds related to the sales of the borrowed Treasury securities plus or minus the additional cash collateral provided or received under the terms of the transactions were $17.7 million at both September 30, 2006, and December 31, 2005. The amount of the hedge will vary from period to period depending upon the amount of commercial mortgage loans that we own and have hedged as of the balance sheet date.

PORTFOLIO ASSET QUALITY

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

At September 30, 2006, and December 31, 2005, our portfolio was graded as follows:

	2006		2005	
Grade ($ in millions)	Portfolio at Value	Percentage of Total Portfolio	Portfolio at Value	Percentage of Total Portfolio
1	$ 1,082.1	26.3%	$ 1,643.0	45.6%
2	2,767.1	67.2	1,730.8	48.0
3	153.4	3.7	149.1	4.1
4	57.9	1.4	26.5	0.7
5	59.1	1.4	57.0	1.6
	$ 4,119.6	100.0%	$ 3,606.4	100.0%

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

Total Grade 4 and 5 portfolio assets were $117.0 million and $83.5 million, respectively, or were 2.8% and 2.3%, respectively, of the total portfolio at value at September 30, 2006, and December 31, 2005. Grade 4 and 5 assets include loans, debt securities, and equity securities. We expect that a number of investments will be in the Grades 4 or 5 categories from time to time. Part of the private equity business is working with troubled portfolio companies to improve their businesses and protect our investment. The number and amount of investments included in Grade 4 and 5 may fluctuate from period to period. We continue to follow our historical practice of working with portfolio companies in order to recover the maximum amount of our investment.

Loans and Debt Securities on Non-Accrual Status. At September 30, 2006, and December 31, 2005, loans and debt securities at value not accruing interest for the total investment portfolio were as follows:

($ in millions)	2006	2005
Loans and debt securities in workout status (classified as Grade 4 or 5)[(1)]		
Private finance		
Companies more than 25% owned	$ 52.3	$ 15.6
Companies 5% to 25% owned	2.7	
Companies less than 5% owned	24.8	11.4
Commercial real estate finance	6.7	12.9
Loans and debt securities not in workout status		
Private finance		
Companies more than 25% owned	36.0	58.0
Companies 5% to 25% owned	7.2	0.5

Companies less than 5% owned	18.3	49.5
Commercial real estate finance	13.7	7.9
Total	$ 161.7	$ 155.8
Percentage of total portfolio	3.9%	4.3%

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

Loans and Debt Securities Over 90 Days Delinquent. Loans and debt securities greater than 90 days delinquent at value at September 30, 2006, and December 31, 2005, were as follows:

($ in millions)	**2006**	**2005**
Private finance	$ 41.2	$ 74.6
Commercial mortgage loans	3.7	6.1
Total	$ 44.9	$ 80.7
Percentage of total portfolio	1.1%	2.2%

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

As a result of these and other factors, the amount of the portfolio that is greater than 90 days delinquent or on non-accrual status may vary from period to period. Loans and debt securities on non-accrual status and over 90 days delinquent should not be added together as they are two separate measures of portfolio asset quality. Loans and debt securities that are in both categories (i.e., on non-accrual status and over 90 days delinquent) totaled $44.9 million and $60.7 million at September 30, 2006, and December 31, 2005, respectively.

PORTFOLIO RETURNS

Since our merger on December 31, 1997, through September 30, 2006, our combined aggregate cash flow Internal Rate of Return (IRR) has been approximately 22% for private finance and CMBS/CDO investments exited during this period. The IRR is calculated using the aggregate portfolio cash flow for all investments exited over this period. For investments exited during this period, we invested capital totaling $3.8 billion. The weighted average holding period of these investments was 35 months. Investments are considered to be exited when the original investment objective has been achieved through the receipt of cash and/or non-cash consideration upon the repayment of our debt investment or sale of an equity investment, or through the determination that no further consideration was collectible and, thus, a loss may have been realized. The aggregate cash flow IRR for private finance investments was approximately 21% and for CMBS/CDO investments was approximately 24% for the same period. The weighted average holding period of the private finance and CMBS/CDO investments was 48 months and 22 months, respectively, for the same period. These IRR results represent historical results. Historical results are not necessarily indicative of future results.

OTHER ASSETS AND OTHER LIABILITIES

Other assets is composed primarily of fixed assets, assets held in deferred compensation trusts, deferred financing and offering costs, and accounts receivable, which includes amounts received in connection with the sale of portfolio companies, including amounts held in escrow, and other receivables from portfolio companies. At September 30, 2006, and December 31, 2005, other assets totaled $119.5 million and $87.9 million, respectively. The increase since year end was primarily the result of amounts received in connection with the sales of Advantage and STS Operating, Inc., that are being held in escrow. See Results of Operations below.

Accounts payable and other liabilities is primarily composed of the liabilities related to the deferred compensation trust and accrued interest, bonus and taxes, including excise tax. At September 30, 2006, and December 31, 2005, accounts payable and other liabilities totaled $133.1 million and $102.9 million, respectively. The increase since year end was primarily the result of an increase in accrued interest payable by $22.2 million. Accrued interest fluctuates from period to period depending on the amount of debt outstanding and the contractual payment dates of the interest on such debt. Interest on our debt is primarily due on a semi-annual basis, which results in fluctuations of the quarter-end liability.

RESULTS OF OPERATIONS

Comparison of Three and Nine Months Ended September 30, 2006 and 2005

The following table summarizes the Company s operating results for the three and nine months ended September 30, 2006 and 2005.

	For the Three Months Ended September 30,			Percentage	For the Nine Months Ended September 30,			Pe
sands, except per share amounts)	**2006**	**2005**	**Change**	**Change**	**2006**	**2005**	**Change**	
	(unaudited)				(unaudited)			
nd Related Portfolio Income								
d dividends	$ 98,668	$ 76,353	$ 22,315	29%	$ 282,982	$ 232,628	$ 50,354	
ther income	14,715	18,504	(3,789)	(20)%	51,868	43,355	8,513	
est and related portfolio income	113,383	94,857	18,526	20%	334,850	275,983	58,867	
	26,109	17,929	8,180	46%	72,455	57,483	14,972	
	25,228	13,969	11,259	81%	67,054	52,302	14,752	
stock options	3,649		3,649	100%	11,852		11,852	
ative	8,153	14,936	(6,783)	(45)%	29,348	58,563	(29,215)	
ating expenses	63,139	46,834	16,305	35%	180,709	168,348	12,361	
ment income before income taxes	50,244	48,023	2,221	5%	154,141	107,635	46,506	
expense (benefit), including excise	1,586	1,889	(303)	(16)%	13,988	7,482	6,506	
ment income	48,658	46,134	2,524	5%	140,153	100,153	40,000	
zed and Unrealized Gains (Losses)								
d gains	9,916	70,714	(60,798)	*	542,991	288,495	254,496	
e in unrealized appreciation or on	19,312	(3,680)	22,992	*	(471,942)	156,026	(627,968)	
ains	29,228	67,034	(37,806)	*	71,049	444,521	(373,472)	
e	$ 77,886	$ 113,168	$ (35,282)	(31)%	$ 211,202	$ 544,674	$ (333,472)	
rnings per common share	$ 0.53	$ 0.82	$ (0.29)	(35)%	$ 1.47	$ 3.99	$ (2.52)	
average common shares outstanding	147,112	138,058	9,054	7%	144,030	136,669	7,361	

* Net realized gains (losses) and net change in unrealized appreciation or depreciation can fluctuate significantly from period to period. As a result, comparisons may not be meaningful.

Total Interest and Related Portfolio Income. Total interest and related portfolio income includes interest and dividend income, loan prepayment premiums, and fees and other income.

Interest and Dividends. Interest and dividend income for the three and nine months ended September 30, 2006 and 2005, was composed of the following:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
($ in millions)	**2006**	**2005**	**2006**	**2005**
Interest				
Private finance loans and debt securities	$ 90.9	$ 67.4	$ 262.1	$ 177.2
CMBS and CDO portfolio				29.4
Commercial mortgage loans	1.7	1.7	6.5	5.2
Cash and cash equivalents, U.S. Treasury bills and other	5.0	2.0	10.9	6.1
Total interest	97.6	71.1	279.5	217.9
Dividends	1.1	5.3	3.5	14.7
Total interest and dividends	$ 98.7	$ 76.4	$ 283.0	$ 232.6

Our interest income from our private finance loans and debt securities has increased period over period as a result of the growth in this portfolio as shown below.

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

The level of portfolio-related interest income, which includes interest paid in cash and in kind, is directly related to the balance of the interest-bearing investment portfolio outstanding during the period multiplied by the weighted average yield. The interest-bearing investments in the portfolio at value and the yield on the interest-bearing investments in the portfolio at September 30, 2006 and 2005, were as follows:

	2006		2005	
($ in millions)	**Value**	**Yield[(1)]**	**Value**	**Yield[(1)]**
Private finance loans and debt securities	$ 2,905.2	12.5%	$ 2,039.6	13.0%
Commercial mortgage loans	94.4	7.7%	121.2	6.6%
Total	$ 2,999.6	12.3%	$ 2,160.8	12.6%

(1) The weighted average yield on loans and debt securities is computed as the (a) annual stated interest on accruing loans and debt securities plus the annual amortization of loan origination fees, original issue discount, and market

discount on accruing loans and debt securities less the annual amortization of loan origination costs, divided by (b) total loans and debt securities at value. The weighted average yield is computed as of the balance sheet date.

The private finance portfolio yield at September 30, 2006, of 12.5% as compared to the private finance portfolio yield of 13.0% at September 30, 2005, reflects the mix of debt investments in the private finance portfolio. The weighted average yield varies from period to period based on the current stated interest on interest-bearing investments and the amount of loans and debt securities for which interest is not accruing. See the discussion of the private finance portfolio yield above under the caption Portfolio and Investment Activity Private Finance.

Dividend income results from the dividend yield on preferred equity interests, if any, or the declaration of dividends by a portfolio company on preferred or common equity interests. Dividend income will vary from period to period depending upon the timing and amount of dividends that are declared or paid by a portfolio company on preferred or common equity interests. Dividend income for the three and nine months ended September 30, 2006, did not include any dividends from BLX. Dividend income for the three and nine months ended September 30, 2005, included $4.0 million and $9.0 million, respectively, of dividends from BLX on the Class B equity interests held by us, which were paid in cash. See the discussion of BLX above under the caption Portfolio and Investment Activity Private Finance.

Fees and Other Income. Fees and other income primarily include fees related to financial structuring, diligence, transaction services, management and consulting services to portfolio companies, commitments, guarantees, and other services and loan prepayment premiums. As a business development company, we are required to make significant managerial assistance available to the companies in our investment portfolio. Managerial assistance includes, but is not limited to, management and consulting services related to corporate finance, marketing, human resources, personnel and board member recruiting, business operations, corporate governance, risk management and other general business matters.

Fees and other income for the three and nine months ended September 30, 2006 and 2005, included fees and other income relating to the following:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
($ in millions)	**2006**	**2005**	**2006**	**2005**
Structuring and diligence	$ 9.3	$ 10.2	$ 28.4	$ 19.1
Management, consulting and other services provided to portfolio companies	2.6	4.0	9.1	10.8
Commitment, guaranty, transaction and other fees from portfolio companies	2.1	1.7	6.7	6.5
Loan prepayment premiums	0.7	2.1	7.7	4.6
Other income		0.5		2.4
Total fees and other income	$ 14.7	$ 18.5	$ 51.9	$ 43.4

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

Structuring and diligence fees for the nine months ended September 30, 2006 and 2005, included structuring fees from both companies more than 25% owned and 5% to 25% owned totaling $10.1 million and $6.8 million, respectively. Structuring and diligence fees from companies 5% to 25% owned for the nine months ended September 30, 2006, included a structuring fee from Advantage Sales and Marketing totaling $2.3 million. Structuring and diligence fees may vary substantially from period to period based on the level of new investment originations and the market rates for these types of fees. Private finance investments funded were $1.9 billion for the nine months ended September 30, 2006, as compared to $1.1 billion for the nine months ended September 30, 2005.

Management fees for the nine months ended September 30, 2006, included $1.8 million in management fees from Advantage prior to its sale on March 29, 2006. See Portfolio and Investment Activity above for further discussion.

Management fees for the three and nine months ended September 30, 2005, included $1.8 million and $4.9 million, respectively, in management fees from Advantage.

Fees and other income related to the CMBS and CDO portfolio for the nine months ended September 30, 2005, were $4.1 million. As noted above, we sold our CMBS and CDO portfolio on May 3, 2005.

Loan prepayment premiums for the nine months ended September 30, 2006, included $5.0 million related to the repayment of our subordinated debt in connection with the sale of our majority equity interest in Advantage on March 29, 2006. See Portfolio and Investment Activity above for further discussion. While the scheduled maturities of private finance and commercial real estate loans generally range from five to ten years, it is not unusual for our borrowers to refinance or pay off their debts to us ahead of schedule. Therefore, we generally structure our loans to require a prepayment premium for the first three to five years of the loan. Accordingly, the amount of prepayment premiums will vary depending on the level of repayments and the age of the loans at the time of repayment.

BLX and Advantage. BLX was our largest investment at value at September 30, 2006, and represented 6.2% of our total assets. Advantage and BLX were our largest investments at September 30, 2005, and together represented 22.9% of our total assets.

Total interest and related portfolio income from these investments for the three and nine months ended September 30, 2006 and 2005, was as follows:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
($ in millions)	**2006**	**2005**	**2006**	**2005**
BLX	$ 6.1	$ 9.9	$ 18.2	$ 26.5
Advantage[(1)]	$	$ 9.6	$ 14.1	