UNIVERSAL SECURITY INSTRUMENTS INC Form 10-Q August 13, 2010

UNITED STATES SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly period ended June 30, 2010

OR

" TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number 001-31747

UNIVERSAL SECURITY INSTRUMENTS, INC. (Exact name of registrant as specified in its charter)

Maryland 52-0898545
(State or other jurisdiction of incorporation or organization) Identification No.)

11407 Cronhill Drive, Suite A

Owings Mills, Maryland 21117 (Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (410) 363-3000

Inapplicable

(Former name, former address and former fiscal year if changed from last report.)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No "

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes "No"

Indicate by check mark if the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. Large accelerated filer "Accelerated filer "Non-Accelerated Filer "Smaller Reporting Company x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Ac	t). Yes
"No x	

At August 12, 2010, the number of shares outstanding of the registrant's common stock was 2,387,887.

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PART I - FINANCIAL INFORMATION

ITEM 1.

FINANCIAL STATEMENTS

UNIVERSAL SECURITY INSTRUMENTS, INC. AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS

		(unaudited)		(audited)	
A CCETC	Ju	ine 30, 2010	Ma	arch 31, 2010	
ASSETS CURRENT ASSETS					
	\$	2,941,799	\$	2 252 621	
Cash and cash equivalents Assets held for investment	Ф		Ф	2,253,631	
Accounts receivable:		4,043,413		4,001,890	
Trade less allowance for doubtful accounts of \$87,851 at June 30, 2010 and March 31, 2010		552,281		266,526	
Other receivables		69,215		70,523	
Receivable from Hong Kong Joint Venture		468,646		212,622	
Amount due from factor		1,195,552		3,824,553	
Inventories, net of allowance for obsolete inventory of \$100,000 at June 30, 2010		1,175,552		3,02 1,333	
and March 31, 2010		3,144,882		3,439,906	
Prepaid expenses		329,688		351,192	
Tepala expenses		327,000		331,172	
TOTAL CURRENT ASSETS		12,745,476		14,420,843	
1011E COMENT NOODIS		12,7 13,170		11,120,013	
DEFERRED TAX ASSET		1,959,581		1,877,156	
INVESTMENT IN HONG KONG JOINT VENTURE		12,588,837		12,153,456	
PROPERTY AND EQUIPMENT – NET		188,007		199,163	
OTHER ASSETS		20,136		20,136	
TOTAL ASSETS	\$	27,502,037	\$	28,670,754	
LIABILITIES AND SHAREHOLDERS' EQUITY					
CURRENT LIABILITIES					
Accounts payable	\$	575,829	\$	689,762	
Hong Kong Joint Venture accounts payable		265,136		1,472,993	
Accrued liabilities:					
Payroll and employee benefits		106,143		232,034	
Commissions and other		31,920		47,001	
TOTAL CURRENT LIABILITIES		979,028		2,441,790	
Long-term obligation		46,459		46,459	
COMMITMENTS AND CONTINGENCIES		-		-	
CHARDING DEDG FOLUTY					
SHAREHOLDERS' EQUITY					
Common stock, \$.01 par value per share; authorized 20,000,000 shares; issued and		4- 2		a - a - a	
outstanding, 2,387,887 shares at June 30, 2010 and March 31, 2010		23,879		23,879	
Additional paid-in capital		13,135,198		13,135,198	

Retained earnings	13,305,295	13,023,428
Other comprehensive income	12,178	-
TOTAL SHAREHOLDERS' EQUITY	26,476,550	26,182,505
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 27,502,037 \$	28,670,754

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

UNIVERSAL SECURITY INSTRUMENTS, INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF EARNINGS (Unaudited)

	Tl	nree Months I 2010	End	ed June 30, 2009
Net sales	\$	3,681,421	\$	5,914,905
Cost of goods sold – acquired from Joint Venture		2,365,287		4,344,489
Cost of goods sold – other		204,892		400,582
GROSS PROFIT		1,111,242		1,169,834
December and development among		167 102		110 151
Research and development expense		167,103		119,151
Selling, general and administrative expense		1,207,882		1,203,078
Operating loss		(263,743)		(152,395)
		()		(- ,,
Other income (expense):				
Interest income		34,868		4,151
Interest expense		(7,064)		(5,642)
LOSS BEFORE EQUITY IN EARNINGS OF JOINT VENTURE		(235,939)		(153,886)
Equity in earnings of Joint Venture		435,381		721,107
Equity in carnings of some venture		433,301		721,107
Income from operations before income taxes		199,442		567,221
Income tax benefit		(82,425)		(44,244)
NET INCOME	\$	281,867	\$	611,465
Net income per share:				
Basic	\$	0.12	\$	0.25
Diluted	\$	0.12	\$	0.25
Dituitu	Ψ	0.12	Ψ	0.23
Shares used in computing net income per share:				
Basic		2,387,887		2,417,338
Diluted		2,395,328		2,422,379

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

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UNIVERSAL SECURITY INSTRUMENTS, INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

	Tł	nree Months I 2010	End	ed June 30, 2009
OPERATING ACTIVITIES				
Net income	\$	281,867	\$	611,465
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization		13,756		14,147
Earnings of the Joint Venture		(435,381)		(721,107)
Stock-based compensation		_		5,703
Changes in operating assets and liabilities:				
Decrease in accounts receivable and amounts due from factor		2,088,530		371,918
Decrease in inventories and prepaid expenses		316,528		1,593,220
Decrease in accounts payable and accrued expenses		(1,462,762)		(1,078,615)
Increase in deferred taxes and other assets		(82,425)		(48,241)
NET CASH PROVIDED BY OPERATING ACTIVITIES		720,113		748,490
INVESTING ACTIVITIES:				
Purchase of assets held for investment		(29,345)		-
Purchase of property and equipment		(2,600)		(2,929)
NET CASH USED IN INVESTING ACTIVITIES		(31,945)		(2,929)
FINANCING ACTIVITIES:				
Purchase and retirement of common stock		-		(95,481)
Other long-term obligations		-		710
NET CASH USED IN FINANCING ACTIVITIES		-		(94,771)
INCREASE IN CASH		688,168		650,790
Cash at beginning of period		2,253,631		284,030
CASH AT END OF PERIOD	\$	2,941,799	\$	934,820
Supplemental information:				
Interest paid	\$	7,064	\$	5,642
Income taxes		-		-

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

UNIVERSAL SECURITY INSTRUMENTS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Statement of Management

The consolidated financial statements include the accounts of Universal Security Instruments, Inc. (USI or the Company) and its majority owned subsidiaries. Significant inter-company accounts and transactions have been eliminated in consolidation. In the opinion of the Company's management, the interim consolidated financial statements include all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the results for the interim periods. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States of America have been condensed or omitted. The interim consolidated financial statements should be read in conjunction with the Company's March 31, 2010 audited financial statements filed with the Securities and Exchange Commission on Form 10-K. The interim operating results are not necessarily indicative of the operating results for the full fiscal year.

Use of Estimates

The preparation of the consolidated financial statements in conformity with GAAP 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 materially from those estimates.

Joint Venture

The Company and its co-venturer, a Hong Kong corporation, each owns a 50% interest in a Hong Kong joint venture, Eyston Company Limited (the "Joint Venture"), that has manufacturing facilities in the People's Republic of China, for the manufacturing of security products. The following represents summarized balance sheet and income statement information of the Joint Venture as of and for the three months ended June 30, 2010 and 2009:

	2010	2009
Net sales	\$ 6,795,331 \$	5,867,623
Gross profit	1,943,791	1,568,646
Net income	830,380	938,812
Total current assets	17,456,253	14,640,539
Total assets	31,119,018	28,932,600
Total current liabilities	4.812.591	6.051,978

During the three months ended June 30, 2010 and 2009, respectively, the Company purchased \$2,229,545 and \$3,064,419 of products from the Joint Venture. For the three month period ended June 30, 2010 and 2009, the Company has increased its earnings of the Joint Venture to reflect a decrease of \$20,191 and \$246,180, respectively, for inter-Company profit in inventory

Income Taxes

The Company recognizes a liability or asset for the deferred tax consequences of temporary differences between the tax basis of assets or liabilities and their reported amounts in the financial statements. These temporary differences will result in taxable or deductible amounts in future years when the reported amounts of the assets or liabilities are recovered or settled. The deferred tax assets are reviewed periodically for recoverability and valuation allowances are

provided, as necessary. The Company follows the financial pronouncement that gives guidance related to the financial statement of recognition and measurement of a tax position taken or expected to be taken in a tax return and requires that we recognize in our financial statements the impact of a tax position, if that position is more likely than not to be sustained upon an examination, based on the technical merits of the position. Interest and penalties related to income tax matters are recorded as income tax expenses,

Assets Held for Investment

Assets held for investment are accounted for as investments available for sale and recorded at their fair value, with unrealized gains and losses reported as a separate component of shareholders' equity in accumulated other comprehensive income. Gains and losses on our investments available for sale are recognized in results of operations as investment income when realized.

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Assets held for investment consist of investments in seven different bond and/or exchange traded funds. All of the Company's investments are measured and recoded at fair value using quoted prices in active markets for identical assets or liabilities (Level 1).

Net Income per Common Share

Basic earnings per common share are computed based on the weighted average number of common shares outstanding during the periods presented. Diluted earnings per common share is computed based on the weighted average number of common shares outstanding plus the effect of stock options and other potentially dilutive common stock equivalents. The dilutive effect of stock options and other potentially dilutive common stock equivalents is determined using the treasury stock method based on the Company's average stock price.

A reconciliation of the weighted average shares of common stock utilized in the computation of basic and diluted earnings per share for the three month periods ended June 30, 2010 and 2009 is as follows:

	2010	Three Months Ended June 30,			
	2010	2009			
		ATTACHED TO AND FORMING PART OF BOND OR POLICY NO.	DATE ENDORSEMENT OR RIDER EXECUTED	* EFFECT DATE CONTROL ENDOR OR RID)F SEMEN
		490PB1542	08/28/07	05/01/07	SPECI IN THE BOND POLICE
			33. = 67 6 7	32.01/0/	
		* ISSUED TO			
Weighted average number of common shares outstanding for		ALLIED CAPITAL CORPORATION			
basic EPS	2,387,887				
	ANTENID	OWNEDCHID DDOVICION			

AMEND OWNERSHIP PROVISION For use with Form 24 MEL3200 - Ed. 7/05

It is agreed that:

The following paragraph is added to Section 10., OWNERSHIP, of the CONDITIONS AND LIMITATIONS: However, coverage provided under the Insuring Agreements of this bond shall be deemed to include amounts which the Insured is legally liable to pay a third party as a direct result of loss otherwise meeting the conditions and limitations of this bond.

Nothing herein contained shall be held to vary, alter, waive, or extend any of the terms, conditions, provisions, agreements or limitations of the above mentioned Bond or Policy, other than as above stated.

By

Authorized Representative

INSURED

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The following spaces preceded by an (*) need not be completed if this endorsement or rider and the Bond or Policy have the same inception date.

ATTACHED TO AND FORMING

DATE ENDORSEMENT

OR

OR RIDER

PART OF BOND OR POLICY NO.

RIDER EXECUTED

12:01 A.M. LOCAL TIME AS SPECIFIED IN THE BOND OR POLICY

490PB1542 08/28/07 05/01/07

ALLIED CAPITAL CORPORATION

CLAIMS EXPENSE For use with Form 24 MEL3203 - Ed. 7/05

It is agreed that:

1. An additional paragraph, as follows, is inserted as the fifth paragraph of the Fidelity Insuring Agreement.

Claims Expense Coverage Single Loss Limit of Liability \$100,000 Claims Expense Single Loss Deductible \$0

Reasonable fees and expenses incurred by the Insured, with prior approval of the Underwriter, for independent accountants or other professional persons conTRcted to determine the amount and extent of loss sustained by the Insured through dishonest or fraudulent acts of any of the Employees. The total liability of the Underwriter for such expense by reason of such acts of any Employee or in which such Employee is concerned or implicated or with respect to any one audit or examination is limited to the amount stated opposite. Claims Expense Coverage Single Loss Limit of Liability, after the application of the Deductible Amount stated opposite. Claims Expense Single Loss Deductible. It is understood, however, that such expense shall be deemed to be loss sustained by the Insured through dishonest or fraudulent act of one or more of the Employees and the liability of the Underwriter under this paragraph of Insuring Agreement (A) shall be part of and not in addition to the Single Loss Limit of Liability stated in Item 3 of the Declarations.

- 2. The attached bond is amended by deleting subsection (u) of Section 2 and by substituting in lieu thereof the following:
 - (u) all fees, costs and expenses incurred by the Insured
 - (1) in establishing the existence of or amount of loss covered under this bond, except to the extent covered under the portion of Insuring Agreement (A) entitled Claims Expense, or
 - (2) as party to any legal proceeding whether or not such legal proceeding exposes the Insured to loss covered by this bond;

Nothing herein contained shall be held to vary, alter, waive, or extend any of the terms, conditions, provisions, agreements or limitations of the above mentioned Bond or Policy, other than as above stated.

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ATTACHED TO AND FORMING DATE ENDORSEMENT OR * EFFECTIVE DATE OF ENDORSEMENT

OR RIDER

PART OF BOND OR POLICY NO. RIDER EXECUTED 12:01 A.M. LOCAL TIME

AS

SPECIFIED IN THE BOND OR POLICY

08/28/07 05/01/07

ALLIED CAPITAL CORPORATION

490PB1542

AMEND INSURING AGREEMENT E For use with Form 24 MEL3207 Ed. 7/05

It is agreed that:

- 1. Insuring Agreement (E), SECURITIES, is replaced with the following:
 - (E) Loss resulting directly from the Insured having, in good faith, for its own account or for the account of others,
 - (1) acquired, sold or delivered, or given value, extended credit or assumed liability, on the faith of, any original
 - (a) Certificated Security,
 - (b) Document of Title
 - (c) deed, mortgage or other instrument conveying title to, or creating or discharging a lien upon, real property,
 - (d) Certificate of Origin or Title,
 - (e) Evidence of Debt
 - (f) corporate, partnership or personal Guarantee
 - (g) Security Agreement
 - (h) Written Instruction or,
 - (i) Statement of Uncertificated Security

which

- (i) bears a signature of any maker, drawer, issuer, endorser, assignor, surety, guarantor, or of any person signing in any other capacity which is a Forgery, or
- (ii) is altered, or
- (iii) is lost or stolen;
- (2) guaranteed in writing or witnessed any signature upon any transfer, assignment, bill of sale, power of attorney, Guarantee, endorsement or any items listed in (a) through (i) above, which guarantee relied upon the Insured s stamp or medallion which was lost or stolen or is a Counterfeit.

(3)

^{*} ISSUED TO

acquired, sold or delivered, or given value, extended credit or assumed liability, on the faith of any item listed in (a) and (d) above which is a Counterfeit.

Actual physical possession of the Items listed in (a) through (i) above by the Insured or its authorized representative, is a condition precedent to the Insured s having relied on the faith of such items. A mechanically reproduced facsimile signature shall be treated the same as a handwritten signature.

- 2. Exclusion (w) of Section 2. EXCLUSIONS, of the CONDITIONS AND LIMITATIONS is replaced with the following:
 - (w) loss involving any Uncertificated Securities except when covered under Insuring Agreement A or E or under the Computer System Rider.

Page 1 of 2

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- 3. Section 1. DEFINITIONS, of the CONDITIONS AND LIMITATIONS is amended as follows:
 - (a) Paragraph (j) is replaced with the following:
 - (j) Instruction means an order to the issuer of an Uncertificated Security requesting that the transfer, pledge, or release from pledge of the Uncertificated Security specified therein be registered.
 - (b) The following Definitions are added:
 - (t) Certificate of Origin or Title means a document issued by a manufacturer of personal property or a governmental agency evidencing the ownership of the personal property and by which ownership is transferred.
 - (u) Document of Title means a bill of lading, dock warrant, dock receipt, warehouse receipt of order for the delivery of goods and also any other document which in the regular course of business or financing is treated as adequately evidencing that the person in possession of it is entitled to receive, hold and dispose of the document and the goods it covers and must purport to be issued by or addressed to a bailee and purport to cover goods in the bailee s possession which are either identified or are fungible portions of an identified mass.
 - (c) Definition (o), Property, is replaced by the following:
 - (o) Property means Money, Certificated Securities, Uncertificated Securities, Negotiable Instruments, Certificates of Deposit, documents of title, Acceptances, Evidences of Debt, security agreements, Withdrawal Orders, certificates of origin or title, Letters of Credit, insurance policies, absTRcts of title, deeds and mortgages on real estate, revenue and other stamps, tokens, unsold state lottery tickets, books of account and other records whether recorded in writing or electronically, gems, jewelry, precious metals of all kinds and in any form, and tangible items of personal property which are not herein before enumerated.

Nothing herein contained shall be held to vary, alter, waive, or extend any of the terms, conditions, provisions, agreements or limitations of the above mentioned Bond or Policy, other than as above stated.

By

Authorized Representative

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ATTACHED TO AND FORMING DATE ENDORSEMENT * EFFECTIVE DATE OF ENDORSEMENT

OR OR RIDER

PART OF BOND OR POLICY NO. RIDER EXECUTED 12:0

12:01 A.M. LOCAL TIME

AS

SPECIFIED IN THE BOND

OR POLICY

490PB1542 08/28/07 05/01/07

* ISSUED TO

ALLIED CAPITAL CORPORATION

AUDIT EXPENSE ENDORSEMENT For use with Form 24 MEL3341 Ed. 8/05

It is agreed that:

The following Insuring Agreement is added as follows:

AUDIT EXPENSE

Expense incurred by the Insured for that part of the cost of audits or examinations required by State or Federal supervisory authorities to be conducted either by such authorities or by independent accountants by reason of the discovery of loss sustained by the Insured through dishonest or fraudulent acts of any of the Employees. The total liability of the Underwriter for such expense by reason of such acts of any Employee or in which such Employee is concerned or implicated or with respect to any one audit or examination is limited to the sum of fifty thousand and 00/100 Dollars (\$50,000); it being understood, however, that such expense shall be deemed to be loss sustained by the Insured through dishonest or fraudulent act of one or more of the Employees and the liability of the Underwriter under this paragraph of Insuring Agreement (A) shall be part of and not in addition to the Single Loss Limit of Liability stated in Item 4 of the Declarations.

Nothing herein contained shall be held to vary, alter, waive, or extend any of the terms, conditions, provisions, agreements or limitations of the above mentioned Bond or Policy, other than as above stated.

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ATTACHED TO AND FORMING DATE ENDORSEMENT OR * EFFECTIVE DATE OF ENDORSEMENT OR RIDER

PART OF BOND OR POLICY NO. RIDER EXECUTED 12:01 A.M. LOCAL TIME AS

490PB1542 08/28/07 05/01/07 SPECIFIED IN THE

SPECIFIED IN THE BOND OR POLICY

* ISSUED TO

ALLIED CAPITAL CORPORATION

AMEND DEDUCTIBLE FOR INVESTMENT COMPANY For use with Form 24 MEL3342 Ed. 8/05

It is agreed that:

1. Section 11. of the Conditions and Limitations (Deductible Amount) is amended by adding an additional paragraph as follows:

There shall be no deductible applicable to any loss under Insuring Agreement A sustained by an Investment Company named as Insured herein.

- 2. Section 1. of the Conditions and Limitations, Definitions, is amended by adding the following:
 - (v) Investment Company means an investment company registered under the Investment Company Act of 1940 and as listed under the names of Insureds on the Declarations.

Nothing herein contained shall be held to vary, alter, waive, or extend any of the terms, conditions, provisions, agreements or limitations of the above mentioned Bond or Policy, other than as above stated.

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ATTACHED TO AND FORMING

DATE ENDORSEMENT OR * EFFECTIVE DATE OF ENDORSEMENT OR

RIDER

PART OF BOND OR POLICY NO. 490PB1542

RIDER EXECUTED 08/28/07

12:01 A.M. LOCAL TIME AS 05/01/07 SPECIFIED IN THE BOND OR POLICY

* ISSUED TO

ALLIED CAPITAL CORPORATION

AMEND GENERAL AGREEMENT F. AND SECTION 5. (a) For use with Form 24 MEL3343 Ed. 8/05

It is agreed that:

1. The first sentence of General Agreement F. NOTICE OF LEGAL PROCEEDINGS AGAINST INSURED-ELECTION TO DEFEND is deleted in its entirety and replaced with the following:

The Insured shall notify the Underwriter at the earliest practicable moment, not to exceed 90 days after notice thereof, of any legal proceeding brought to determine the Insured s liability for any loss, claim or damage, which, if established, would constitute a collectible loss under this bond.

2. Section 5a. of the Conditions and Limitations (Notice/Proof - Legal Proceedings Against Underwriter) is deleted in its entirety and replaced with the following:

Section 5.

(a) At the earliest practicable moment, not to exceed 90 days, after discovery of loss by the Risk Manager, Compliance Officer or Chief Financial Officer of the Insured, the Insured shall give the Underwriter notice thereof.

Nothing herein contained shall be held to vary, alter, waive, or extend any of the terms, conditions, provisions, agreements or limitations of the above mentioned Bond or Policy, other than as above stated.

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Authorized Representative

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	DATE	
	ENDORSEMENT	* EFFECTIVE DATE OF
ATTACHED TO AND FORMING PART OF	OR	ENDORSEMENT OR RIDER
	RIDER	12:01 A.M.
BOND OR POLICY NO.	EXECUTED	LOCAL TIME AS
		SPECIFIED IN
		THE BOND OR
		POLICY
490PB1542	08/28/07	05/01/07

^{*} ISSUED TO

ALLIED CAPITAL CORPORATION

UNAUTHORIZED SIGNATURE RIDER For use with Form 24 MEL3350 Ed. 8/05

It is agreed that:

1. The attached bond is hereby amended by adding an additional Insuring Agreement as follows:

Loss resulting directly from the Insured having accepted from, paid to, or cashed for a person present on the premises of the Insured, any check withdrawal order, or draft, made or drawn on a customer s account which bears the signature or endorsement of one other than a person whose name and signature is on the application on file with the Insured as a signatory on such account.

It shall be a condition precedent to the Insured s right of recovery under this Insuring Agreement that the Insured shall have on file signatures of all persons who are authorized signatories on such account; and the Insured must maintain written instructions outlining the acceptance procedures of all checks, withdrawal orders, or drafts made or drawn on such account.

- 2. The Single Loss Limit of Liability for the coverage shall be twenty million and no/l00ths (\$20,000,000) Dollars, it being understood, however, that such liability shall be part of and not in addition to the Aggregate Limit of Liability stated in Item 3 of the Declarations of the attached bond.
- 3. The Underwriter shall not be liable under the Unauthorized Signatures Rider for any loss on account of any instrument unless the amount of such instrument shall be excess of two hundred & fifty thousand and no/l00ths (\$250,000) Dollars (herein called the Deductible Amount) and unless such loss on account of such instrument, after deducting all recoveries on account of such instrument made prior to the payment of such loss by the Underwriter, shall be in excess of such Deductible Amount and then for such excess only, but in no event more than the Unauthorized Signatures Rider, if the amount of such coverage is less than the attached bond.

Nothing herein contained shall be held to vary, alter, waive, or extend any of the terms, conditions, provisions, agreements or limitations of the above mentioned Bond or Policy, other than as above stated.

By

Authorized Representative INSURED

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ATTACHED TO AND FORMING DATE ENDORSEMENT OR * EFFECTIVE DATE OF ENDORSEMENT OR RIDER

PART OF BOND OR POLICY NO. RIDER EXECUTED 12:01 A.M. LOCAL TIME AS

SPECIFIED IN THE BOND OR POLICY

490PB1542 08/28/07 05/01/07

* ISSUED TO

ALLIED CAPITAL CORPORATION

AMEND GENERAL AGREEMENT B. - ADDITIONAL OFFICES OR EMPLOYEES CONSOLIDATION, MERGER OR PURCHASE OF ASSETS - NOTICE For use with Form 24 MEL3424 Ed. 9/05

It is agreed that:

- 1. Part (i) of Section B of the GENERAL AGREEMENTS, ADDITIONAL OFFICES OR EMPLOYEES CONSOLIDATION, MERGER OR PURCHASE OF ASSETS NOTICE is deleted and replaced with the following:
 - (i) give the Underwriter written notice of the consolidation, merger or purchase or acquisition of assets or liabilities within 90 days after such consolidation, merger or purchase or acquisition, and
- 2. The reporting provisions outlined in Section B. of the General Agreements are deemed to be waived in connection with any consolidation, merger or purchase or acquisition involving assets or liabilities, unless the consolidation, merger or purchase of assets increase the Insured stotal assets by 10% and above.

Nothing herein contained shall be held to vary, alter, waive, or extend any of the terms, conditions, provisions, agreements or limitations of the above mentioned Bond or Policy, other than as above stated.

By

Authorized Representative

INSURED

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* This is not a certified copy of any policy form. * Actual policy provisions may differ.*

The following spaces preceded by an (*) need not be completed if this endorsement or rider and the Bond or Policy have the same inception date.

ATTACHED TO AND FORMING DATE ENDORSEMENT * EFFECTIVE DATE OF ENDORSEMENT OR OR RIDER

PART OF BOND OR POLICY NO. RIDER EXECUTED 12:01 A.M. LOCAL TIME

AS

SPECIFIED IN THE BOND

OR POLICY

490PB1542 08/28/07 05/01/07

* ISSUED TO

ALLIED CAPITAL CORPORATION

AMEND SECTION 12. - TERMINATION OR CANCELATION ENDORSEMENT (For use with Form 24) MEL3456 Ed. 9/2005

It is agreed that:

1. The second paragraph of Section 12. of the Conditions and Limitations, Termination or Cancellation, is deleted and replaced with the following:

This bond terminates as to any Employee or any partner, officer or employee of any Processor - (a) as soon as the RISK MANAGEMENT, INTERNAL AUDIT OR LEGAL/COMPLIANCE DEPARTMENT of the Insured not in collusion with such person, learns of any dishonest or fraudulent act committed by such person at any time, whether in the employment of the Insured or otherwise, whether or not the type covered under Insuring Agreement (A), against the Insured or any other person or entity, without prejudice to the loss of any Property then in transit in the custody of such person, or (b) 90 days after the receipt by the Insured of written notice from the Underwriter of its desire to cancel the bond as to such person. It is agreed that the termination provisions outlined in sub-paragraph (a) will not apply if the dishonest or fraudulent act was committed outside the course of their employment at the Insured, occurred more than three years prior to discovery and involved a sum less than \$10,000. It is further agreed that this bond will cover any Employee which a prior dishonesty record provided the Underwriter or a prior bond Underwriter has agreed to waive the terminations provisions for a previously reported dishonest or fraudulent act.

Nothing herein contained shall be held to vary, alter, waive, or extend any of the terms, conditions, provisions, agreements or limitations of the above mentioned Bond or Policy, other than as above stated.

By

Authorized Representative

INSURED

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* This is not a certified copy of any policy form. * Actual policy provisions may differ.*

The following spaces preceded by an (*) need not be completed if this endorsement or rider and the Policy have the same inception date.

ATTACHED TO AND DATE ENDORSEMENT * EFFECTIVE DATE OF ENDORSEMENT OR FORMING OR RIDER

PART OF POLICY NO. RIDER EXECUTED 12:01 A.M. LOCAL TIME AS SPECIFIED IN THE POLICY

490PB1542 08/28/07 05/01/07

ALLIED CAPITAL CORPORATION

EXPANDED NAMED INSURED ENDORSEMENT For use with Form 24 MEL3340 - Ed. 8/05

It is agreed that:

Item 1. Name of Insured on the Declarations Page shall read as follows:

1. Allied Capital Corporation

A.C. Corporation

Allied Investment Corporation

Allied Capital Holdings, LLC

Allied Capital REIT, Inc.

Allied Capital Beleitingungsberatung GmbH

Allied Investment Holdings, LLC

Allied Capital Property LLC

Allied Capital Equity LLC

9586-I-25 East Frontage Road, Longmont, CO 80504 LLC

A.C. Management Services, LLC

A.C. Portfolio Company I, Inc.

ACC Universal Corporation

AIC Universal Corporation

ACN Corporation

Allied Vermoegensverwaltungs - und - Beteilgungs GmbH

Capital Lending I, LLC

Directory Lending Corporation

EGI Investments, Inc.

Environmental Lending Corporation

F.A. Television Holdings, LLC

Futuronics, LLC

GAC Investments, Inc.

Lab I, LLC

Mezzanine Funding, LLC

MVL Group, Inc.

NPH, Inc.

R.A. Acquisition Corporation

^{*} ISSUED TO

RWI, LLC SM Mezzanine Corporation Total Foam, Inc. Van Ness Hotel, Inc. Business Loan Express, LLC Allied Capital Senior Debt Fund, LP Allied Capital Senior Debt Fund, LTD Allied Capital Senior Debt Funding 2007-1

- 2. and any subsidiary company, corporation, partnership, general and limited partnership or joint venture now existing or hereafter created or acquired in which any of the aforementioned Named Insured(s) (either individually or in combination) own(s) more than 50% interest, or over which said Named Insured(s) exercise(s) management/audit control; subject, however, to the reporting provisions contained GENERAL AGREEMENT B; and
- 3. any Employee welfare benefit plan or welfare plan, employee pension benefit plan or pension plan, or employee benefit plan sponsored, maintained or administered by the Insured whether or not such plans are subject to regulation under (1) Title I of the Employee Retirement Income Security Act of 1974 or amendments thereto or any common or statutory law of the United States of America.

Nothing herein contained shall be held to vary, alter, waive, or extend any of the terms, conditions, provisions, agreements or limitations of the above mentioned Bond or Policy, other than as above stated.

By Authorized Representative

The following spaces preceded by an (*) need not be completed if this endorsement or rider and the Policy have the same inception date.

ATTACHED TO AND FORMING

PART OF POLICY NO.

RIDER EXECUTED

RIDER EXECUTED

12:01 A.M. LOCAL TIME AS SPECIFIED IN THE POLICY

490PB1542

08/28/07

05/01/07

* ISSUED TO ALLIED CAPITAL CORPORATION

Amend Section 3. - Discovery - Designate Persons to Discover Loss MEL2252 - Ed. 1/05 - For use with Form 24

It is agreed that:

Section 3. DISCOVERY, of the CONDITIONS AND LIMITATIONS, is replaced with the following:
This bond applies to loss discovered by the Insured during the Bond Period. Discovery occurs when **an individual with the title of VP or above or any individual in Risk Management, Internal Audit or Legal/Compliance Departments** of the Insured first becomes aware of facts which would cause a reasonable person to assume that a loss of a type covered by this bond has been or will be incurred, regardless of when the act or acts causing or contributing to such loss occurred, even though the exact amount or details of loss may not then be known.

Discovery also occurs when an individual with the title of VP or above or any individual in Risk Management, Internal Audit or Legal/Compliance Departments of the Insured receives notice of an actual or potential claim in which it is alleged that the Insured is liable to a third party under circumstances which, if true, would constitute a loss under this bond.

Nothing herein contained shall be held to vary, alter, waive, or extend any of the terms, conditions, provisions, agreements or limitations of the above mentioned Policy, other than as above stated.

By

Authorized Representative

The following spaces preceded by an (*) need not be completed if this endorsement or rider and the Policy have the same inception date.

DATE **ENDORSEMENT** * EFFECTIVE DATE OF ATTACHED TO AND FORMING PART OF ENDORSEMENT OR RIDER OR RIDER 12:01 A.M. BOND OR POLICY NO. **EXECUTED** LOCAL TIME AS SPECIFIED IN THE BOND OR **POLICY** 05/01/07 490PB1542 08/28/07

ALLIED CAPITAL CORPORATION

LOSS PAYEE ENDORSEMENT MEL1841 Ed. 9-04

In consideration of the premium charged, it is agreed that:

- 1. At the written request of the named Insured, any payment in satisfaction of loss covered by said bond involving Money or other Property in which LaSalle Bank National Association has an interest shall be paid by an instrument issued to LaSalle Bank National Association and the named Insured as joint loss-payees, subject to the following conditions and limitations:
 - a. The attached bond is for the sole use and benefit of the named Insured as expressed herein. LaSalle Bank National Association shall not be considered as an Insured under the bond, nor shall it otherwise have any rights or benefits under said bond.
 - b. Notwithstanding any payment made under the terms of this rider or the execution of more than one of such similar rider, the amount paid for any one loss occurrence or otherwise in accordance with the terms of this bond shall not exceed the limits of liability as set forth in the Declarations Page.
 - c. Nothing herein is intended to alter the terms, conditions and limitations of the bond.
- 2. This rider shall become effective as of 12:01 a.m. on 05/01/2007 Nothing herein contained shall be held to vary, alter, waive, or extend any of the terms, conditions, provisions, agreements or limitations of the above mentioned Policy, other than as above stated.

By

Authorized Representative INSURED

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^{*} ISSUED TO

Item 5. The liability of the Underwriter is subject to the terms of the following riders attached hereto:

#1, #2, #3, #4

Item 6. The Insured by the acceptance of this bond gives notice to the Underwriter terminating or canceling prior bond(s) or policy (ies) No (s) 672-00-81 such termination or cancellation to be effective as of the time this bond becomes effective.

SECRETARY PRESIDENT

AUTHORIZED REPRESENTATIVE

COUNTERSIGNATURE MARSH USA, INC. 1166 AVENUE OF THE AMERICAS NEW YORK, NY 10036-3712 DATE

COUNTERSIGNED AT

2

NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA.

A CAPITAL STOCK COMPANY 175 WATER STREET, NEW YORK, NY 10038

FOLLOW FORM BOND

Various provisions in this bond restrict coverage. Read the entire bond carefully to determine rights, duties and what is and is not covered.

Throughout this bond, the words you and your refer to the Named Insured as shown in Item 1 of the Declarations. The words we, us and our refer to the Company providing this Bond.

In consideration of the payment of the premium and in reliance upon the statements in the Declarations and in the Application, we agree with you to provide coverage as follows:

INSURING AGREEMENT

I. Coverage

- A. We will pay on your behalf the Ultimate Net Loss in excess of the Underlying Bond as shown in Item 4 of the Declarations, but only up to an amount not exceeding our Limit of Liability as in Item 3 of the Declarations and only after the issuers of the Underlying Bond have paid or have been held liable to pay the full amount of limits of liability of the Underlying Bond. Except for the terms, definitions, conditions and exclusions of this bond, the coverage provided by this bond shall follow the terms, definitions, conditions and exclusions of the Underlying Bond as shown in Item 4 of the Declarations.
- B. The Limit of Liability shown in Item 3 of the Declarations states the most we will pay regardless of the number of Insureds, claims made or suits brought or persons, organizations making claims or bringing suits.

II. Definition

A. Ultimate Net Loss

The term Ultimate Net Loss means the amount payable in settlement of the loss of the Insured after making deductions for all recoveries and for other valid and collectible Bonds, except however the Underlying Bond shown in Item 4 of the Declarations.

III. Conditions

A. Maintenance of Limit of Liability of Underlying Bond

The limit of liability of the Underlying Bond shall be maintained in full force and effect during the period of this bond. Under no circumstances, including but not limited to bankruptcy, insolvency or inability to pay at the issue of the Underlying Bond, will we drop down and replace the Underlying Bond or assume any obligation of the Underlying Bond.

If you fail to comply with this requirement, we will only be liable to the same extent that we would have been had you fully complied with this requirement.

B. Cancellation

1. You may cancel this bond. You must mail or deliver advance written notice to us stating when the cancellation is to take effect.

1

- 2. We may cancel this bond. If we cancel because of non-payment of premium, we must mail or deliver to you not less than ten- (10) days advance written notice stating when the cancellation is to take effect. If we cancel for any other reason, we must mail or deliver to you not less than thirty- (30) days advance written notice stating when the cancellation is to take effect. Mailing that notice to you at your mailing address shown in Item 1 of the Declarations will be sufficient to prove notice.
- 3. The bond period will end on the day and hour stated in the cancellation notice.
- 4. If we cancel, earned premium will be calculated pro rata based on the time this bond was in force.
- 5. If you cancel, earned premium will be calculated based on short rate tables.
- 6. The first Named Insured in Item 1 of the Declarations shall act on behalf of all other Insureds with respect to the giving and receiving of notice of cancellation and the receipt of any refund that may become payable under this bond.
- 7. Any of these provisions that conflict with a law that controls the cancellation of the insurance in this bond is changed by this statement to comply with that law.

C. Cancellation of Underlying Insurance Bond

This bond is canceled upon cancellation of the Underlying Bond. You must promptly notify us of the cancellation of the Underlying Bond. Such notice must be made when you send a notice of cancellation of the Underlying Bond to, or when you receive such notice from, the issuer of the Underlying Bond.

D. Changes to Underlying Bond

You must promptly notify us of any changes to the Underlying Bond which are made after its inception. Any changes made to the Underlying Bond after its inception shall not affect the terms and conditions of this bond, which shall continue to apply as though no change had been made to the Underlying Bond.

E. Notice of Claim or Loss

You must notify us in writing as soon as practicable when you become aware of any claim or loss under the Underlying Bond or any bond which may give rise to any claim or loss under this bond.

F. Payment of Premium

The first named Insured shown in Item 1 of the Declarations shall be responsible for payment of all premiums when due.

In Witness Whereof, we have caused this bond to be executed and attested, but this bond shall not be valid unless countersigned by one of our duly authorized representatives, where required by law.

SECRETARY PRESIDENT 2

ENDORSEMENT#1

This endorsement, effective 12:01 am May 1, 2007 forms a part of policy number 742-02-34 issued to ALLIED CAPITAL CORPORATION

by National Union Fire Insurance Company of Pittsburgh, Pa.

THIS ENDORSEMENT CHANGES THE POLICY. PLEASE READ IT CAREFULLY. COVERAGE TERRITORY ENDORSEMENT

Payment of loss under this policy shall only be made in full compliance with all United States of America economic or trade sanction laws or regulations, including, but not limited to, sanctions, laws and regulations administered and enforced by the U.S. Treasury Department s Office of Foreign Assets Control (OFAC).

AUTHORIZED REPRESENTATIVE

Page 1 of 1

ENDORSEMENT# 2

This endorsement, effective 12:01 am May 1, 2007 forms a part of policy number 742-02-34 issued to ALLIED CAPITAL CORPORATION

by National Union Fire Insurance Company of Pittsburgh, Pa.

Wherever used in this endorsement: 1) we , us , our , and Insurer mean the insurance company which issued this poli and 2) you , your , named Insured , First Named Insured , and Insured mean the Named Corporation, Named Organization, Named Sponsor, Named Insured, or Insured stated in the declarations page; and 3) Other Insured(s) means all other persons or entities afforded coverage under the policy.

WASHINGTON, D.C. CANCELLATION/NONRENEWAL ENDORSEMENT

In consideration of the premium charged, it is understood and agreed that the cancellation/nonrenewal provisions of this policy are amended to read as follows:

A) Cancellation

If this policy has been in effect for thirty (30) days or more, the Insurer may cancel this policy only if one or more of the following reasons apply:

- 1) Insured has refused or failed to pay a premium due under the terms of the policy;
- 2) Insured or Other Insured(s) have made a material and willful misstatement or omission of fact to the Insurer or its employees, agents or brokers in connection with any application to, or claim against the Insurer; or
- 3) Property or other interest of the Insured shall have been transferred to a person other than the Insured or beneficiary, unless the transfer is permissible under the terms of the policy, or unless the property, interest or use thereof shall have materially changed with respect to its insurability.

The Insurer will mail or deliver to the named Insured notice of cancellation at least thirty (30) days prior to the date of cancellation. For cancellation as described under 2) and 3) above, the Insurer will mail or deliver a copy of the notice to the Superintendent of Insurance at least thirty (30) days before the date of cancellation.

B) Nonrenewal

If the Insurer decides not to renew this policy the Insurer will mail or deliver to the named Insured the Insurer s notice of nonrenewal at least thirty (30) days before the end of the policy period.

The Insurer will mail or deliver notice of cancellation or nonrenewal to the agent or broker at least five (5) days prior to the Insurer s mailing of notice to the named Insured.

ENDORSEMENT# 2 (continued)

The Notice of cancellation or nonrenewal will be mailed or delivered to Insured s last known address and will include the reason(s) for cancellation or nonrenewal. The envelope containing the notice shall be labeled Important Insurance Notice in at least 18 point type or larger.

All other terms, conditions and exclusions shall remain the same.

AUTHORIZED REPRESENTATIVE

-2-

RIDER#3

This rider, effective 12:01 am May 1, 2007 forms a part of bond number 742-02-34 issued to ALLIED CAPITAL CORPORATION by National Union Fire Insurance Company of Pittsburgh, Pa.

Excess Follow Form Drop Down Rider

It is agreed that:

- 1. It is a condition of the attached bond that the Underlying Policy or Policies shall be maintained in full effect in the amount of \$20,000,000 SingleLoss/\$40,000,000 Aggregate Limit of Liabilty during the period of the attached bond except for any reduction in the Aggregate Limit(s) of Liability contained therein solely by payment of claims under any Underlying Coverage Section(s) or Insuring Agreement(s).
- 2. If, by reason of the payment of any claim or claims under any Underlying Coverage Section(s) or Insuring Agreement(s), by Underwriters during the period of the attached bond which reduces the Aggregate Limit(s) of Liability of the Underlying Policy, the attached bond shall apply excess of the reduced Aggregate Limit(s) of Liability of the Underlying Policy but only for claim(s) or loss(es) under Section B, Financial Institution Bond. In the event of the exhaustion of the underlying limit(s), the attached bond shall continue in force as primary insurance under Section B, Financial Institution Bond, and the Deductible set forth in the Schedule of the Underlying Policy shall apply to the attached bond.
- 3. However, in the event of any reinstatement of the Underlying Aggregate Limit(s) of Liability, the attached bond shall apply as excess of the reinstated Underlying Aggregate Limit(s) of Liability.
- 4. Nothing herein contained shall be held to vary, alter, waive or extend any of the terms, limitations, conditions or agreements of the attached bond other than as above stated.
- 5. This rider shall become effective as of 12:01 a.m. standard time on as specified in the bond.

AUTHORIZED REPRESENTATIVE

ENDORSEMENT#4

This rider, effective 12:01 am May 1, 2007 forms a part of

bond number 742-02-34

issued to ALLIED CAPITAL CORPORATION

by National Union Fire Insurance Company of Pittsburgh, Pa.

FORMS INDEX ENDORSEMENT

The contents of the Policy is comprised of the following forms:

FORM NUMBER	EDITION DATE	FORM TITLE
63674	10/95	Follow Form Bond - Dec
63675	10/95	Follow Form Bond - Guts
89644	07/05	COVERAGE TERRITORY ENDORSEMENT (OFAC)
52136	08/95	DISTRICT OF COLUMBIA AMENDATORY -
		CANCELLATION/NONRENEWAL
MNSCPR		EXCESS FOLLOW FORM DROP DOWN RIDER
78859	10/01	Forms Index Endorsement

ALL OTHER TERMS, CONDITIONS AND EXCLUSIONS REMAIN UNCHANGED.

AUTHORIZED REPRESENTATIVE

Page 1 of 1

AMERICAN INTERNATIONAL COMPANIES®

National Union Fire Insurance Company of Pittsburgh, Pa.

A Capital Stock Company 175 Water Street New York, New York 10038 Follow Form Bond DECLARATIONS

Bond Number: 742-02-37

Item 1. Named ALLIED CAPITAL CORPORATION

Insured:

Address: 1919 PENN AVE NW LBBY 3

WASHINTON, DC 20006-3448

Item 2. Bond Period: From May 1, 2007 to May 1, 2008 at

12:01 A.M. Standard Time at the Address of the Named Insured shown above

Item 3. Limit of Liability: \$20,000,000 (Fidelity Coverage Only) Part of \$50,000,000 excess of \$25,000,000

Item 4. Schedule of Primary Underlying Excess Policies (Herein Collectively The Underlying Program): Underlying Primary Policy:

Insured: Travelers Insurance Company

Policy # 490PB1542 Single Loss \$20,000,000

Limit:

Aggregate \$40,000,000

Limit:

Deductible: \$250,000

Policy Period: May 1, 2007 to May 1, 2008

Underlying First Excess Policy:

Insured: National Union Fire Insurance Company

Policy # 7420234 Single Loss \$5,000,000

Limit:

Aggregate \$10,000,000

Limit:

Deductible: Excess of \$20,000,000 + \$250,000 retention

Policy Period: May 1, 2007 to May 1, 2008

Item 5. Endorsements Attached: #1, #2, #3, #4 & #5

Premium: \$24,660 MARSH USA, INC. 1166 AVENUE OF THE AMERICAS NEW YORK, NY 10036-3712

Ву

Authorized Representative

NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA.

A Capital Stock Company 175 Water Street NEW YORK, New York 10038 Follow Form Bond

Various provisions in this bond restrict coverage. Read the entire bond carefully to determine rights, duties and what is and is not covered.

Throughout this bond, the words you and your refer to the Named Insured as shown in Item 1 of the Declarations. The words we, us and our refer to the Company providing this insurance.

In consideration of the payment of the premium and in reliance upon the statements in the Declarations and in the Application, we agree with you to provide coverage as follows:

INSURING AGREEMENT

I. Coverage

- A. We will pay on your behalf the Ultimate Net Loss in excess of the Underlying Bond as shown in Item 4 of the Declarations, but only up to an amount not exceeding our Limit of Liability as shown in Item 3 of the Declarations and only after the issuers of the Underlying Bond have paid or have been held liable to pay the full amount of limits of insurance of the Underlying Bond. Except for the terms, definitions, conditions and exclusions of this bond, the coverage provided by this bond shall follow the terms, definitions, conditions and exclusions of the Underlying Bond as shown in Item 4 of the Declarations.
- B. The Limit of Liability shown in Item 3 of the Declarations states the most we will pay regardless of the number of Insureds, claims made or suits brought or persons or organizations making claims or bringing suits.

II. Definition

A. Ultimate Net Loss

The term Ultimate Net Loss means the amount payable in settlement of the loss of the Insured after making deductions for all recoveries and for other valid and collectible bonds, excepting however the Underlying Bond shown in Item 4 of the Declarations.

III. Conditions

A. Maintenance of Limit of Liability of Underlying Bond

The limit of liability of the Underlying Bond shall be maintained in full force and effect during the period of this bond. Under no circumstances, including but not

limited to bankruptcy, insolvency or inability to pay at the issue of the Underlying Bond, will we drop down and replace the Underlying Bond or assume any obligation of the Underlying Bond.

If you fail to comply with this requirement, we will only be liable to the same extent that we would have been had you fully complied with this requirement.

B. Cancellation

- 1. You may cancel this bond. You must mail or deliver advance written notice to us stating when the cancellation is to take effect.
- 2. We may cancel this bond. If we cancel because of non-payment of premium, we must mail or deliver to you not less than ten (10) days advance written notice stating when the cancellation is to take effect. If we cancel for any other reason, we must mail or deliver to you not less than ninety (90) days advance written notice stating when the cancellation is to take effect. Mailing that notice to you at your mailing address shown in Item 1 of the Declarations will be sufficient to prove notice.
- 3. The bond period will end on the day and hour stated in the cancellation notice.
- 4. If we cancel, earned premium will be calculated pro rata based on the time this bond was in force.
- 5. If you cancel, earned premium will be calculated based on short rate tables.
- 6. The first Named Insured in Item 1 of the Declarations shall act on behalf of all other Insureds with respect to the giving and receiving of notice of cancellation and the receipt of any refund that may become payable under this bond.
- 7. Any of these provisions that conflict with a law that controls the cancellation of the insurance in this bond is changed by this statement to comply with that law.

C. Cancellation of Underlying Bond

This bond is canceled upon cancellation of the Underlying Bond. You must promptly notify us of the cancellation of the Underlying Bond. Such notice must be made when you send a notice of cancellation of the Underlying Bond to, or when you receive such notice from, the issuer of the Underlying Bond.

D. Changes to Underlying Bond

You must promptly notify us of any changes to the Underlying Bond which are made after its inception date. Any changes made to the Underlying Bond after its inception shall not affect the terms and conditions of this bond, which shall continue to apply as though no change had been made to the Underlying Bond.

E. Notice of Claim or Loss

You must notify us in writing as soon as practicable when you become aware of any claim or loss under the Underlying Bond or any bond which may give rise to any claim or loss under this bond.

F. Payment of Premium

The first Named Insured shown in Item 1 of the Declarations shall be responsible for payment of all premiums when due.

In Witness Whereof, we have caused this bond to be executed and attested, but this bond shall not be valid unless countersigned by one of our duly authorized representatives, where required by law.

SECRETARY PRESIDENT

This endorsement, effective 12:01 am May 1, 2007 forms a part of policy number 742-02-37 issued to ALLIED CAPITAL CORPORATION

by National Union Fire Insurance Company of Pittsburgh, Pa.

Wherever used in this endorsement: 1) we , us , our , and Insurer mean the insurance company which issued this poli and 2) you , your , named Insured , First Named Insured , and Insured mean the Named Corporation, Named Organization, Named Sponsor, Named Insured, or Insured stated in the declarations page; and 3) Other Insured(s) means all other persons or entities afforded coverage under the policy.

WASHINGTON, D.C. CANCELLATION/NONRENEWAL ENDORSEMENT

In consideration of the premium charged, it is understood and agreed that the cancellation/nonrenewal provisions of this policy are amended to read as follows:

A) Cancellation

If this policy has been in effect for thirty (30) days or more, the Insurer may cancel this policy only if one or more of the following reasons apply:

- 1) Insured has refused or failed to pay a premium due under the terms of the policy;
- 2) Insured or Other Insured(s) have made a material and willful misstatement or omission of fact to the Insurer or its employees, agents or brokers in connection with any application to, or claim against the Insurer; or
- 3) Property or other interest of the Insured shall have been transferred to a person other than the Insured or beneficiary, unless the transfer is permissible under the terms of the policy, or unless the property, interest or use thereof shall have materially changed with respect to its insurability.

The Insurer will mail or deliver to the named Insured notice of cancellation at least thirty (30) days prior to the date of cancellation. For cancellation as described under 2) and 3) above, the Insurer will mail or deliver a copy of the notice to the Superintendent of Insurance at least thirty (30) days before the date of cancellation.

B) Nonrenewal

If the Insurer decides not to renew this policy the Insurer will mail or deliver to the named Insured the Insurer s notice of nonrenewal at least thirty (30) days before the end of the policy period.

The Insurer will mail or deliver notice of cancellation or nonrenewal to the agent or broker at least five (5) days prior to the Insurer s mailing of notice to the named Insured.

ENDORSEMENT# 1 (continued)

The Notice of cancellation or nonrenewal will be mailed or delivered to Insured s last known address and will include the reason(s) for cancellation or nonrenewal. The envelope containing the notice shall be labeled Important Insurance Notice in at least 18 point type or larger.

All other terms, conditions and exclusions shall remain the same.

AUTHORIZED REPRESENTATIVE

-2-

This endorsement, effective 12:01 am May 1, 2007 forms a part of policy number 742-02-37 issued to ALLIED CAPITAL CORPORATION

by National Union Fire Insurance Company of Pittsburgh, Pa.

DROP DOWN RIDER

It is agreed that:

- 1. It is a condition of the attached bond that the Underlying Policy or Policies shall be maintained in full effect in the amount of \$25,000,000 Single Loss/ \$50,000,000 Aggregate Limit of Liability during the period of the attached bond except for any reduction in the Aggregate Limit(s) of Liability contained therein solely by payment of claims under any Underlying Coverage Section(s) or Insuring Agreement(s).
- 2. If, by reason of the payment of any claim or claims under any Underlying Coverage Section(s) or Insuring Agreement(s), by Underwriters during the period of the attached bond which reduces the Aggregate Limit(s) of Liability of the Underlying Policy, the attached bond shall apply excess of the reduced Aggregate Limit(s) of Liability of the Underlying Policy but only for claim(s) or loss(es) under Section B, Financial Institution Bond. In the event of the exhaustion of the underlying limit(s), the attached bond shall continue in force as primary insurance under Section B, Financial Institution Bond, and the Deductible set forth in the Schedule of the Underlying Policy shall apply to the attached bond.
- 3. However, in the event of any reinstatement of the Underlying Aggregate Limit(s) of Liability, the attached bond shall apply as excess of the reinstated Underlying Aggregate Limit(s) of Liability.
- 4. Nothing herein contained shall be held to vary, alter, waive or extend any of the terms, limitations, conditions or agreements of the attached bond other than as above stated.
- 5. This rider shall become effective as of 12:01 a.m. standard time on as specified in the bond.

AUTHORIZED REPRESENTATIVE

This endorsement, effective 12:01 am May 1, 2007 forms a part of policy number 742-02-37 issued to ALLIED CAPITAL CORPORATION

by National Union Fire Insurance Company of Pittsburgh, Pa.

CO-SURETY RIDER

It is agreed that:

- 1. The term Underwriter as used in the attached bond shall be construed to mean, unless otherwise specified in this rider, all the Companies executing the attached bond.
- 2. Each of said Companies shall be liable only for such proportion of any Single Loss under the attached bond as the amount underwritten by such Company, as specified in the Schedule forming a part hereof, bears to the Aggregate Limit of Liability of the attached bond, but in no event shall any of said Companies be liable for an amount greater than that underwritten by it.
- 3. In the absence of a request from any of said Companies to pay premiums directly to it, premiums for the attached bond may be paid to the Controlling Company for the account of all of said Companies.
- 4. In the absence of a request from any of said Companies that notice of claim and proof of loss be given to or filed directly with it, the giving of such notice to and the filing of such proof with, the Controlling Company shall be deemed to be in compliance with the conditions of the attached bond for the giving of notice of loss and the filing of proof of loss, if given and filed in accordance with said conditions.
- 5. The Controlling Company may give notice in accordance with the terms of the attached bond, terminating or canceling the attached bond as an entirety or as to any Employee, and any notice so given shall terminate or cancel the liability of all of said Companies as an entirety or as to such Employee, as the case may be.
- 6. Any Company other than the Controlling Company may give notice in accordance with the terms of the attached bond, terminating or canceling the entire liability of such other Company under the attached bond or as to any Employee.
- 7. In the absence of a request from any of said Companies that notice of termination or cancellation by the Insured of the attached bond in its entirety be given to or filed directly with it, the giving of such notice in accordance with the terms of the attached bond to the Controlling Company shall terminate or cancel the liability of

ENDORSEMENT# 3 (Continued)

This endorsement, effective 12:01 am May 1, 2007 forms a part of policy number 742-02-37 issued to *ALLIED CAPITAL CORPORATION*

by National Union Fire Insurance Company of Pittsburgh, Pa.

all of said Companies as an entirety. The Insured may terminate or cancel the entire liability of any Company, other than the Controlling Company, under the attached bond by giving notice of such termination or cancellation to such other Company, and shall send copy of such notice to the Controlling Company.

Controlling Company

Underwritten for the sum. of \$20,000,000 Single Loss, part of \$50,000,000/\$40,000,000 Aggregate limit of Liability, part of \$100,000,000

National Union Fire Insurance Company of Pittsburgh, Pa. Controlling Company

By:

Authorized Representative John Doyle

ENDORSEMENT# 3 (Continued)

This endorsement, effective 12:01 am May 1, 2007 forms a part of policy number 742-02-37 issued to ALLIED CAPITAL CORPORATION

by National Union Fire Insurance Company of Pittsburgh, Pa.

Underwritten for the sum. of \$20,000,000 Single Loss Limit of Liability part of \$50,000,000/\$40,000,000 Aggregate limit of liability, part of \$100,000,000 **Zurich Insurance Company**

By:

Authorized Representative

Underwritten for the sum. of \$10,000,000 Single Loss Limit of Liability part of \$50,000,000/\$20,000,000 Aggregate limit of liability, part of \$100,000,000 **Chubb Insurance Company**

By:

Authorized Representative

By:

AUTHORIZED REPRESENTATIVE

This endorsement, effective 12:01 am May 1, 2007 forms a part of policy number 742-02-37 issued to ALLIED CAPITAL CORPORATION

by National Union Fire Insurance Company of Pittsburgh, Pa.

THIS ENDORSEMENT CHANGES THE POLICY. PLEASE READ IT CAREFULLY.

COVERAGE TERRITORY ENDORSEMENT

Payment of loss under this policy shall only be made in full compliance with all United States of America economic or trade sanction laws or regulations, including, but not limited to, sanctions, laws and regulations administered and enforced by the U.S. Treasury Department s Office of Foreign Assets Control (OFAC).

AUTHORIZED REPRESENTATIVE

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This endorsement, effective 12:01 am May 1, 2007 forms a part of policy number 742-02-37 issued to ALLIED CAPITAL CORPORATION

by National Union Fire Insurance Company of Pittsburgh, Pa.

FORMS INDEX ENDORSEMENT

The contents of the Policy is comprised of the following forms:

FORM NUMBER	EDITION DATE	FORM TITLE
63674	10/95	FOLLOW FORM BOND NUFIC DEC PAGE
63675	10/95	FOLLOW FORM BOND NUFIC GUTS
	08/95	DISTRICT OF COLUMBIA AMENDATORY -
52136		CANCELLATION/NONRENEWAL
MNSCPT		DROP DOWN RIDER
MNSCPT		CO-SURETY RIDER
89644	07/05	COVERAGE TERRITORY ENDORSEMENT
MNSCPT		FORMS INDEX ENDORSEMENT

AUTHORIZED REPRESENTATIVE

ENDORSEMENT# 3 (Continued)

This endorsement, effective 12:01 am May 1, 2007 forms a part of policy number 742-02-37 issued to ALLIED CAPITAL CORPORATION

by National Union Fire Insurance Company of Pittsburgh, Pa.

Underwritten for the sum. of \$20,000,000 Single Loss Limit of Liability part of \$50,000,000/\$40,000,000 Aggregate limit of liability, part of \$100,000,000 **Zurich Insurance Company**

By:

Authorized Representative

Underwritten for the sum. of \$10,000,000 Single Loss Limit of Liability part of \$50,000,000/\$20,000,000 Aggregate limit of liability, part of \$100,000,000 Federal Insurance Company 8212-6541

By: /s/ ILLEGIBLE Authorized Representative

By:

AUTHORIZED REPRESENTATIVE

This endorsement, effective 12:01 am May 1, 2007 forms a part of policy number 742-02-37 issued to ALLIED CAPITAL CORPORATION

by National Union Fire Insurance Company of Pittsburgh, Pa.

CO-SURETY RIDER

It is agreed that:

- 1. The term Underwriter as used in the attached bond shall be construed to mean, unless otherwise specified in this rider, all the Companies executing the attached bond.
- 2. Each of said Companies shall be liable only for such proportion of any Single Loss under the attached bond as the amount underwritten by such Company, as specified in the Schedule forming a part hereof, bears to the Aggregate Limit of Liability of the attached bond, but in no event shall any of said Companies be liable for an amount greater than that underwritten by it.
- 3. In the absence of a request from any of said Companies to pay premiums directly to it, premiums for the attached bond may be paid to the Controlling Company for the account of all of said Companies.
- 4. In the absence of a request from any of said Companies that notice of claim and proof of loss be given to or filed directly with it, the giving of such notice to and the filing of such proof with, the Controlling Company shall be deemed to be in compliance with the conditions of the attached bond for the giving of notice of loss and the filing of proof of loss, if given and filed in accordance with said conditions.
- 5. The Controlling Company may give notice in accordance with the terms of the attached bond, terminating or canceling the attached bond as an entirety or as to any Employee, and any notice so given shall terminate or cancel the liability of all of said Companies as an entirety or as to such Employee, as the case may be.
- 6. Any Company other than the Controlling Company may give notice in accordance with the terms of the attached bond, terminating or canceling the entire liability of such other Company under the attached bond or as to any Employee.
- 7. In the absence of a request from any of said Companies that notice of termination or cancellation by the Insured of the attached bond in its entirety be given to or filed directly with it, the giving of such notice in accordance with the terms of the attached bond to the Controlling Company shall terminate or cancel the liability of

ENDORSEMENT# 3 (Continued)

This endorsement, effective 12:01 am May 1, 2007 forms a part of policy number 742-02-37 issued to *ALLIED CAPITAL CORPORATION*

by National Union Fire Insurance Company of Pittsburgh, Pa.

all of said Companies as an entirety. The Insured may terminate or cancel the entire liability of any Company, other than the Controlling Company, under the attached bond by giving notice of such termination or cancellation to such other Company, and shall send copy of such notice to the Controlling Company.

Controlling Company

Underwritten for the sum. of \$20,000,000 Single Loss, part of \$50,000,000/\$40,000,000 Aggregate limit of Liability, part of \$100,000,000

National Union Fire Insurance Company of Pittsburgh, Pa.

By:

Authorized Representative John Doyle

ENDORSEMENT# 3 (Continued)

This endorsement, effective 12:01 am May 1, 2007 forms a part of policy number 742-02-37 issued to ALLIED CAPITAL CORPORATION

by National Union Fire Insurance Company of Pittsburgh, Pa.

Underwritten for the sum. of \$20,000,000 Single Loss Limit of Liability part of \$50,000,000/\$40,000,000 Aggregate limit of liability, part of \$100,000,000 **Zurich Insurance Company**

By: /S/ ILLEGIBLE Authorized Representative

Underwritten for the sum. of \$10,000,000 Single Loss Limit of Liability part of \$50,000,000/\$20,000,000 Aggregate limit of liability, part of \$100,000,000 **Chubb Insurance Company**

By:

Authorized Representative

By:

AUTHORIZED REPRESENTATIVE

FIDELITY/CRIME DIVISION FINANCIAL INSTITUTION EXCESS FOLLOW FORM CERTIFICATE

The Great American Insurance Company, herein called the UNDERWRITER

Bond Number: FS 550-39-09 -01

Name and Address of Insured: Allied Capital Corporation

1919 Pennsylvania Avenue, NW

Washington, DC 20006

The UNDERWRITER, in consideration of an agreed premium, and in reliance upon the statements and information furnished to the UNDERWRITER by the Insured, and subject to the terms and conditions of the underlying coverage scheduled in ITEM 3 below, as excess and not contributing insurance, agrees to pay the Insured for loss which:

- (a) Would have been paid under the Underlying Coverage but for the fact that such loss exceeds the limit of liability of the Underlying Carrier(s) listed in ITEM 3, and
- (b) for which the Underlying Carrier has made payment, and the Insured has collected, the full amount of the expressed limit of the Underlying Carrier s liability.

ITEM 1. BOND PERIOD: from 12:01 a.m. on 11/16/2007 to 12:01 a.m. on 05/01/2008

(inception) (expiration)

ITEM 2. LIMIT OF LIABILITY AT INCEPTION: \$25,000,000

ITEM 3. UNDERLYING COVERAGE:

A) CARRIER: St. Paul Mercury Insurance Company

LIMIT: \$20,000,000 BOND NUMBER: 490PB1542

BOND PERIOD: 05/01/2007-05/01/2008

B) CARRIER: National Union Fire Insurance Company of Pittsburgh, PA

LIMIT: \$5,000,000 BOND NUMBER: 742-02-34

BOND PERIOD: 05/01/2007 - 05/01/2008

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C) CARRIER: National Union Fire Insurance Company of Pittsburgh, PA and

others

LIMIT: \$50,000,000 BOND NUMBER: 742-02-37

BOND PERIOD: 07/26/2007 - 05/01/2008

ITEM 4. Coverage provided by this Bond is subject to the following attached Rider(s): Rider No. 1 (Drop Down)

ITEM 5. By acceptance of this Bond, you give us notice canceling prior Bond No. **N/A**, the cancellation to be effective at the same time this Bond becomes effective.

In witness whereof, the UNDERWRITER has caused this certificate to be signed by an Attorney-in-Fact of the UNDERWRITER this 5 day of September, 2007.

THE GREAT AMERICAN INSURANCE COMPANY

By: /s/ [ILLEGIBLE]

(Attorney-in-Fact)

Excess Follow Form Certificate May, 2003 ed.

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FIDILITY/CRIME DIVISION RIDER NO. 1 DROP DOWN RIDER

To be attached to and form part of Excess Follow Form Bond No. FS 550-39-09 - 00

In favor of Allied Capital Corporation

It is agreed that:

The attached bond is amended by adding an additional Condition as follows:

- 1. All Underlying Coverage detailed in ITEM 3 of the Declarations shall be maintained in full force and effect during the period of this Bond, except for any reduction in the aggregate limits contained therein solely by payment of claims, including court costs and attorneys fees.
- 2. If by reason of the payment of any claim or claims by the Underwriter during the period of this coverage, which reduces the aggregate limits of the underlying coverage, this Bond shall respond excess over the Single Loss Limits of Liability of the Underlying Carrier(s) named in Item 3 of the Declarations until the reduced Annual Aggregate Limits are exhausted; and in such event, this Bond shall continue in force as Primary Bond, and the Deductible set forth on the Declarations Page of the Primary Bond shall apply to this Bond.
- 3. Nothing herein contained shall be held to vary, alter, waive, or extend any of the terms, limitations, conditions, or provisions of the attached Bond other than as above stated
- 4. This rider shall become effective as of 12:01 a.m. on 05/01/2007 standard time as specified in the Bond.

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