American Capital

ACAS – NASDAQ

Hold

Specialty Finance

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Book Value Surprises on Continued Asset Appreciation

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Analysis of Sales/Earnings

Changes	From (Previous)	To (Current)
Rating	—	Hold
Target Price	—	NA
FY11E EPS (Net)	$0.67	$0.78
FY12E EPS (Net)	—	$0.77
FY11E Rev (Net)	—	$532.0
FY12E Rev (Net)	—	—

Stock Data	
Price (02/16/11):	$9.41
52-Week Range:	$9 – $3
Market Cap.(mm):	$3,325.5
Shr.O/S-Diluted (mm):	353.4
Avg Daily Vol (3 Mo):	2,963,416
Dividend ($):	$0.00
Yield (%):	0.0%
Book Value/Share:	$10.71
S&P Index:	1,336.32

EPS (Net)	2010E	2011E	2012E
Q1	$0.19A	$0.19	$0.19
Q2	0.14A	0.19	0.19
Q3	0.17A	0.20	0.19
Q4	0.19A	0.20	0.19
FY Dec	$0.68A	$0.78	$0.77
P/E	13.8x	12.1x	12.2x

Rev (Net)	2010E	2011E	2012E
FY Dec	$592.6	$532.0	NE

1 Year Price History for ACAS

4Q10 Earnings Summary: Quick take on the quarter was very positive marked by an earnings beat, asset appreciation, strong monetizations and further deleveraging. ACAS reported NOI of $0.19/share versus consensus of $0.17 and our estimate of $0.16. Credit Quality was relatively stable. While the portfolio increased in value, more loans went on non-accrual status than returned to performing status. ACAS had 3 loans totaling $59 million return to performing status while 4 loans totaling $83 million went onto non-accrual status. Book value increased by $1.12/share to $10.71, well above our $10.00 estimate. The appreciation was fairly broad-based from ECAS (+$0.35), investment portfolio (+$0.24), structured products (+$0.16), ACAS asset management (+$0.14) and retained earnings (+$0.19). ACAS outlined $1.40 of future book value appreciation over the next few years that we believe has a high probability of occurring, plus the potential for additional portfolio equity appreciation and earnings retention. Asset Monetizations and prepayments remained strong as ACAS received $440 million in net proceeds from the sale/refi of portfolio investments. ACAS paid down $100 million of restructured debt and $150 million of securitization debt. Debt outstanding was $2.2 billion ($1.0 in restructured debt and $1.2 in securitizations) and ACAS paid down an additional $150mln of restructured debt in 1Q11. Continued de-leveraging will occur as the securitization debt will be paid down as assets pledged as collateral repay. Our earnings estimates increase due to a higher assumed yields on the asset portfolio. On the conference call management noted that 3Q11 quarter interest income was depressed by $13 million due to one-time movements around non-accruals which didn't occur this quarter. On last quarter's call there was no mention of the one-time revenue pressure so our expected yield going forward was too low. See note continued on page 2.

<u>Earnings estimates (cont)</u> Our 2011 estimate increases to $0.78 from $0.65 (near the $0.76 level we were previously at before lowering estimates after 3Q10 results). Our 2012 estimate increases to $0.78 from $0.64. Over the next 2-3 years while ACAS repositions the portfolio into more interest bearing investments we believe ACAS will be more of a book value story than an earnings story. In the near-term we suspect ACAS will continue to de-lever the balance sheet through debt reduction and asset appreciation (if the economy cooperates). We do not expect significant new originations in the portfolio until 2012 and we do not expect a dividend until at least 2012 and maybe 2013 as management realizes losses on debt investments in the portfolio to offset taxable earnings.

Investment Thesis: We believe ACAS will continue to grow book value through the retention of earnings (meaning no dividend for the next couple of years) and potential appreciation of current investments. If the economy continues to improve we estimate longer-term book value for ACAS over the next 2 years will range from $13-$14, which would imply a $11.70 - $12.60 stock based on the 0.9x current price/book multiple. As a result we believe there is 20-35% upside in the stock from the current price over the next 2 years (10-17% annualized). However, we would note that no component of that return is a dividend and as such we view ACAS as a higher risk, higher volatility option. We continue to believe investors have better risk adjusted opportunities in other BDCs, currently paying on average 9% dividends plus 5% expected appreciation annually.

Improving debt marks and retained earnings have the potential to push book value into the $13-14 range over the next two years. In the quarter, ACAS book value improved $1.12/share to $10.71 primarily driven by asset mark improvements on the ECAS discount ($0.35/share), private finance portfolio marks ($0.24/share), structured product appreciation ($0.16/share), and American Capital LLC ($0.14/share). As we have seen in the past several quarters, ACAS's book equity is closely tied to an economic recovery, and the main question the market is asking on the name is *"where will book value go over the next several quarters?"* In order to provide clarity on where book value could end up, management provided several data points on what could be key drivers of book value over the next several quarters. See **Figure 1**. These drivers include: (1) the ECAS discount to NAV—which may dissipate over time as ECAS approaches its late 2012 debt refinance date, (2) improving marks in ECAS performing debt—currently ECAS is valued at 90% of cost, and to the extent these prepay at cost ECAS NAV would increase, and (3) improving marks on ACAS performing debt—a portion of ACAS debt investments are held below cost and to the extent that these assets are repaid at par this would provide a boost NAV. In total, management's potential appreciation drivers would add $1.38/share to book value and we believe this would likely occur over the next two years. In addition we believe ACAS will continue to retain income (no dividend) through 2012 which will increase book value by another $1.60; for a total increase of ~$3.00. Note that this does not include any potential appreciation on $1.6 billion of ACAS's common/preferred equity investments (excluding ECAS). This "free option" on ACAS equity provides investors additional potential book value upside, yet it is hard to say what exactly it will return to shareholders as this is dependent on a continued economic recovery.

Figure 1 – Potential Book Value Appreciation

	NAV *(per share)*	Potenital Writeup *($ millions)*	Potenital Writeup *(per share)*
ACAS 12/31/10 NAV	$10.71		
+ ECAS discount to NAV		234	$0.68
+ ECAS performing debt repaid @ cost		176	$0.51
+ ACAS performing debt repaid @ cost		61	$0.18
Potential ACAS NAV upside provided by management	***$12.09***		***$1.38***
+ Potential equity appreicaiton from 2011 retained income		274	$0.80
+ Potential equity appreicaiton from 2012 retained income		273	$0.80
Stifel Estimated ACAS NAV upside	**$13.68**		$2.97

Source: Company Reports

Repayments will be elevated and the portfolio will shrink in 2011. Repayments in ACAS portfolio over the preceding four quarters have been; $160mln, $350mln, $305mln and $475mln. Management commented that 60% of that repayment activity in 4Q was driven by third parties and the remainder was initiated by ACAS because they believed the market price to exit those assets was attractive. The difficult modeling question going forward is now that ACAS has reached the stated goal for leverage (0.6:1 debt-to-equity) will management view the market price for their assets a bit differently and thus will repayments slow? We are modeling that repayments will decline from current levels but still remain elevated; our assumption is that repayments will run $200mln per quarter in 2011. Proceeds from these repayments will continue to be used to repay securitization debt (mandated) and we believe the additional repayments from unencumbered assets will be used in 2011 to retire additional restructured debt (8% interest expense) on the balance sheet.

While the repayment totals could differ from our assumption, what we do know (or at least we think we do) is that the portfolio will shrink in 2011. We believe this to be true because of the balance sheet dynamics. ACAS has a large securitization ($1.3bln of debt) and about half of their earning assets are pledged as collateral to that debt. The securitization is out of the reinvestment period so every “pledged” asset that repays must be used to repay securitization debt. Also of note is that the securitization has violated covenants so all interest income generated by those pledged assets also goes to pay down the securitization debt. What this means is that $0 cash associated with pledged assets (interest or principle) can be used to pay overhead costs (salaries, benefits, etc). This means that the income generated by the half of assets that are not pledged ($70-$75mln of income) is needed to pay overhead cost and there really isn’t any operating cash flow to reinvest. The only cash flow available to reinvest is unencumbered repayments (primarily equity investments, but will include some subordinated debt investments). We estimate about half of the repayments will be available to make new originations; and we believe for the next few quarters management will use those proceeds to retire 9% debt. We believe new originations will begin to pick up in the second half of 2011.

When does ACAS begin to make new investments? We believe ACAS will begin to originate new investments second half of 2011. Our assumption is that originations are $125 million per quarter and we assume they are 11-12% interest earning assets. Following the turbulent last couple of years management has commented several times about its desire to have a diverse book of debt instruments that are well suited for a securitization vehicle. The securitization vehicles in the BDC sector (including ACAS’) held up well during the financial crisis. While some securitizations trapped cash none were forced to liquidate and all proved to be very stable sources of leverage. We believe ACAS will look to use securitization debt in the future as a significant funding vehicle.

Company Description

ACAS is structured as an internally managed BDC. ACAS target investment size is $10 - $75 million and the company can invest in any part of the capital structure including senior debt, subordinated debt, equity, uni-tranche debt (senior and sub-debt combined into one investment) and full-company buyouts. Over the past several years ACAS has increased its focus on full company buy-outs.

American Capital Strategies
[NASD: ACAS]
Financial Model
Ward/Mason/Bock 314-342-2714 / 2194 / 2918
(in thousands, except per share data)

	2010	1Q11E	2Q11E	3Q11E	4Q11E	2011E	Q112E	Q212E	Q312E	Q412E	2012E
Income Statement Summary											
Revenues											
Interest & Dividends	$546,000	$126,520	$124,942	$123,306	$121,464	$496,232	$121,335	$123,113	$124,874	$126,619	$495,941
Fee Income	$54,000	13,000	13,000	13,000	13,000	$52,000	13,000	13,000	13,000	13,000	$52,000
Total Revenues	$600,000	$139,520	$137,942	$136,306	$134,464	$548,232	$134,335	$136,113	$137,874	$139,619	$547,941
Expenses											
Interest on Debt	177,000	23,103	20,315	18,365	16,426	78,209	16,527	17,587	18,652	19,725	72,491
Salaries and Employee Benefits	134,000	34,000	34,000	34,000	34,000	136,000	34,927	35,389	35,847	36,301	142,465
General and Administrative	64,000	15,000	15,000	15,000	15,000	60,000	14,777	14,972	15,166	15,358	60,274
Total Operating Expenses	$396,000	$72,103	$69,315	$67,365	$65,426	$274,209	$66,231	$67,948	$69,665	$71,384	$275,229
Income Tax Expense	0	0	0	0	0	0	0	0	0	0	0
Net Operating Income (NOI)	**$204,000**	**$67,417**	**$68,627**	**$68,941**	**$69,038**	**$274,023**	**$68,104**	**$68,165**	**$68,209**	**$68,235**	**$272,712**
Total Net Realized Gain (Loss)	(576,000)	0	0	0	0	0	0	0	0	0	0
Total Net Unrealized Gain (Loss)	1,370,000	50,000	50,000	50,000	50,000	200,000	50,000	50,000	50,000	50,000	200,000
Net Income	**$998,000**	**$117,417**	**$118,627**	**$118,941**	**$119,038**	**$474,023**	**$118,104**	**$118,165**	**$118,209**	**$118,235**	**$472,712**
Weighted Average Diluted Shares Outstanding	330,700	353,400	353,400	353,400	353,400	353,400	353,400	353,400	353,400	353,400	353,400
Per Share Data											
NOI per Share	**$0.68**	**$0.19**	**$0.19**	**$0.20**	**$0.20**	**$0.78**	**$0.19**	**$0.19**	**$0.19**	**$0.19**	**$0.77**
NOI + Realized Gains per Share	($1.15)	$0.19	$0.19	$0.20	$0.20	$0.78	$0.19	$0.19	$0.19	$0.19	$0.77
Diluted EPS	$3.00	$0.33	$0.34	$0.34	$0.34	$1.34	$0.33	$0.33	$0.33	$0.33	$1.34
Total Distributions to Shareholders	**$0.00**	**$0.00**	**$0.00**	**$0.00**	**$0.00**	**$0.00**	**$0.00**	**$0.00**	**$0.00**	**$0.00**	**$0.00**
NAV per Share (Book Value)	$10.71	$11.06	$11.40	$11.75	$12.10	$12.10	$12.44	$12.79	$13.13	$13.48	$13.48
Portfolio Summary ($ in millions)											
Investment Portfolio	$5,475	$5,375	$5,275	$5,175	$5,075	$5,075	$5,130	$5,185	$5,240	$5,295	$5,295
Debt	$2,259	$1,892	$1,673	$1,454	$1,235	$1,235	$1,172	$1,109	$1,045	$982	$982
Equity	$3,668	$3,785	$3,904	$4,023	$4,142	$4,142	$4,260	$4,378	$4,497	$4,615	$4,615
Debt/Equity	61.6%	50.0%	42.9%	36.1%	29.8%	29.8%	27.5%	25.3%	23.3%	21.3%	21.3%
Total Assets/Senior Securities	262%	300%	333%	377%	435%	435%	464%	495%	530%	570%	570%
Funded Investments	$ 234	$ 50	$ 50	$ 50	$ 50	$ 200	$ 125	$ 125	$ 125	$ 125	$ 500
Net Investment Growth	$ (1,059)	$ (150)	$ (150)	$ (150)	$ (150)	$ (600)	$ 5	$ 5	$ 5	$ 5	$ 20
Ratios											
Revenue Drivers											
Interest Inc/Avg Interest-Bearing Investments	12.16%	12.20%	12.10%	12.00%	11.90%	12.05%	11.80%	11.70%	11.60%	11.50%	11.65%
Interest Inc/Avg Total Investments	8.56%	9.33%	9.39%	9.44%	9.48%	8.54%	9.51%	9.55%	9.58%	9.62%	8.79%
Expense Drivers											
% Restructured Debt		39.6%	41.2%	43.3%	46.1%		55.1%	65.2%	76.5%	89.3%	
% Securitization Debt		60.4%	58.8%	56.7%	53.9%		44.9%	34.8%	23.5%	10.7%	
Weighted Average Yield		3.5%	3.6%	3.7%	3.9%		4.5%	5.2%	5.9%	6.8%	
Difference due to amortized fees		1.0%	1.0%	1.0%	1.0%		1.0%	1.0%	1.0%	1.0%	
Weighted Average Cost of Debt	5.28%	4.45%	4.56%	4.70%	4.89%	4.65%	5.49%	6.17%	6.93%	7.78%	6.59%
Salaries and Benefits/Total Revenues	22.3%	24.4%	24.6%	24.9%	25.3%	24.8%	26.0%	26.0%	26.0%	26.0%	26.0%
G & A/ Total Revenues	10.7%	10.8%	10.9%	11.0%	11.2%	10.9%	11.0%	11.0%	11.0%	11.0%	11.0%

Sources: Company Reports, Stifel Nicolaus Estimates

American Capital Strategies
[NASD: ACAS]
Financial Model
Ward/Mason/Bock 314-342-2714 / 2194 / 2918
(in thousands, except per share data)

	2010	Q111E	Q211E	Q311E	Q411E	2011E	Q112E	Q212E	Q312E	Q412E	2012E
Balance Sheet Data											
Assets											
Senior Debt	1,282,000	1,392,959	1,498,919	1,599,878	1,695,838	1,695,838	1,842,466	1,991,845	2,143,974	2,298,852	2,298,852
Sub Debt	1,783,000	1,750,434	1,717,868	1,685,301	1,652,735	1,652,735	1,670,647	1,688,558	1,706,469	1,724,381	1,724,381
Preferred	1,134,000	1,032,663	934,325	838,988	746,651	746,651	677,792	607,284	535,126	461,318	461,318
CMBS & CDO	199,000	195,365	191,731	188,096	184,461	184,461	186,460	188,459	190,458	192,458	192,458
Warrants	79,000	77,557	76,114	74,671	73,228	73,228	74,022	74,816	75,609	76,403	76,403
Common	998,000	926,022	856,043	788,065	722,087	722,087	678,612	634,038	588,363	541,589	541,589
Investments at fair value	5,475,000	5,375,000	5,275,000	5,175,000	5,075,000	5,075,000	5,130,000	5,185,000	5,240,000	5,295,000	5,295,000
Cash and cash equivalents	269,000	119,000	119,000	119,000	119,000	119,000	119,000	119,000	119,000	119,000	119,000
Inv. in unconsolidated operating subsidiary											
Due from unconsolidated operating subsidiary											
Restricted Cash	185,000	185,000	185,000	185,000	185,000	185,000	185,000	185,000	185,000	185,000	185,000
Interest Receivable	37,000	37,000	37,000	37,000	37,000	37,000	37,000	37,000	37,000	37,000	37,000
Other	118,000	118,000	118,000	118,000	118,000	118,000	118,000	118,000	118,000	118,000	118,000
Total assets	**$6,084,000**	**$5,834,000**	**$5,734,000**	**$5,634,000**	**$5,534,000**	**$5,534,000**	**$5,589,000**	**$5,644,000**	**$5,699,000**	**$5,754,000**	**$5,754,000**
Liabilities											
Accounts payable and accrued liabilities											
Interest rate deriv agreements	106,000	106,000	106,000	106,000	106,000	106,000	106,000	106,000	106,000	106,000	106,000
Other liabilities	51,000	51,000	51,000	51,000	51,000	51,000	51,000	51,000	51,000	51,000	51,000
Inv. in unconsolidated operating subsidiary											
Due to unconsolidated subsidiary											
Accrued Dividends payable	0	0	0	0	0	0	0	0	0	0	0
Debt outstanding	2,259,000	1,891,583	1,672,956	1,454,014	1,234,977	1,234,977	1,171,872	1,108,708	1,045,499	982,264	982,264
Exchanged Debt		749,000	689,000	629,000	569,000		646,000	723,000	800,000	877,000	
New Debt		0	0	0	0		0	0	0	0	
Securitizations		1,142,583	983,956	825,014	665,977		525,872	385,708	245,499	105,264	
Revolving credit facility ($1.38B commitment)											
Total liabilities	**2,416,000**	**2,048,583**	**1,829,956**	**1,611,014**	**1,391,977**	**1,391,977**	**1,328,872**	**1,265,708**	**1,202,499**	**1,139,264**	**1,139,264**
Shareholders' Equity											
Common stock	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000
Capital in excess of par value	7,131,000	7,131,000	7,131,000	7,131,000	7,131,000	7,131,000	7,131,000	7,131,000	7,131,000	7,131,000	7,131,000
Unearned Compensation	0	0	0	0	0	0	0	0	0	0	0
Note receivable from sale of common stock	0	0	0	0	0	0	0	0	0	0	0
Undistributed net realized earnings	(1,136,000)	(1,068,583)	(999,956)	(931,014)	(861,977)	(861,977)	(793,872)	(725,708)	(657,499)	(589,264)	(589,264)
Unrealized appreciation of investments	(2,330,000)	(2,280,000)	(2,230,000)	(2,180,000)	(2,130,000)	(2,130,000)	(2,080,000)	(2,030,000)	(1,980,000)	(1,930,000)	(1,930,000)
Total shareholders' equity	**$3,668,000**	**$3,785,417**	**$3,904,044**	**$4,022,986**	**$4,142,023**	**$4,142,023**	**$4,260,128**	**$4,378,292**	**$4,496,501**	**$4,614,736**	**$4,614,736**
Average Investment Portfolio											
Average Portfolio	5,620,750	5,425,000	5,325,000	5,225,000	5,125,000	5,275,000	5,102,500	5,157,500	5,212,500	5,267,500	5,185,000
Average Interest-Bearning	4,865,868	4,384,711	4,357,132	4,327,553	4,295,974	4,341,342	4,328,525	4,426,756	4,526,087	4,626,518	4,476,972
Average Interest-Bearning less Non-Accruals	4,597,118	4,148,211	4,130,307	4,110,203	4,082,824	4,117,886	4,113,065	4,208,986	4,306,007	4,404,128	4,258,047
Average External AUM	1,398,000	1,398,000	1,398,000	1,398,000	1,398,000	1,398,000	1,398,000	1,398,000	1,398,000	1,398,000	1,398,000
Average Assets	6,332,000	5,959,000	5,784,000	5,684,000	5,584,000	5,752,750	5,561,500	5,616,500	5,671,500	5,726,500	5,644,000
Average Debt	3,304,625	2,075,291	1,782,269	1,563,485	1,344,495	1,691,385	1,203,425	1,140,290	1,077,104	1,013,882	1,108,675
Average Shareholders Equity	2,952,500	3,726,709	3,786,022	3,963,515	4,082,505	3,889,688	4,201,075	4,260,158	4,437,396	4,555,618	4,363,562
Average Unrealized Appreciation	(3,038,250)	(2,305,000)	(2,280,000)	(2,205,000)	(2,155,000)	(2,236,250)	(2,105,000)	(2,080,000)	(2,005,000)	(1,955,000)	(2,036,250)

Sources: Company Reports, Stifel Nicolaus Estimates

Important Disclosures and Certifications

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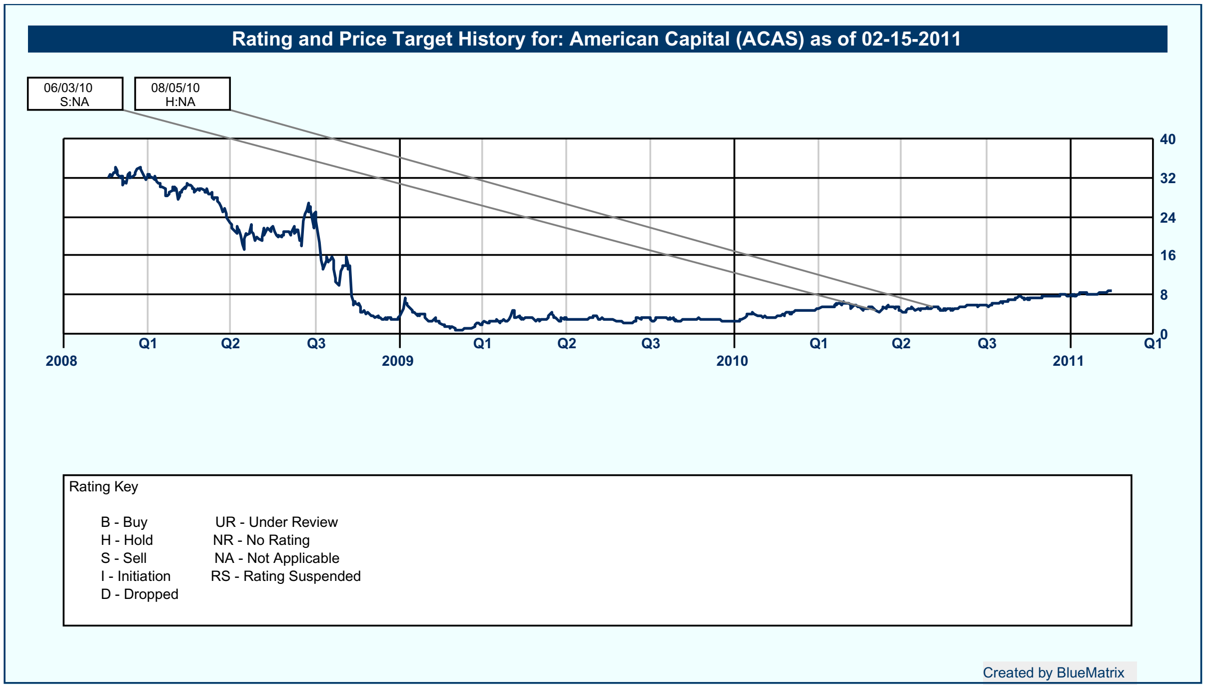

For a price chart with our ratings and target price changes for ACAS go to
http://sf.bluematrix.com/bluematrix/Disclosure?ticker=ACAS

BDC investments may not be appropriate for all equity investors. Please seek appropriate consultation to determine suitability.

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Stifel, Nicolaus & Company, Inc.'s research analysts receive compensation that is based upon (among other factors) Stifel Nicolaus' overall investment banking revenues.

Our investment rating system is three tiered, defined as follows:

BUY -For U.S. securities we expect the stock to outperform the S&P 500 by more than 10% over the next 12 months. For Canadian securities we expect the stock to outperform the S&P/TSX Composite Index by more than 10% over the next 12 months. For other non-U.S. securities we expect the stock to outperform the MSCI World Index by more than 10% over the next 12 months. For yield-sensitive securities, we expect a total return in excess of 12% over the next 12 months for U.S. securities as compared to the S&P 500 and Canadian securities as compared to the S&P/TSX Composite Index.

HOLD -For U.S. securities we expect the stock to perform within 10% (plus or minus) of the S&P 500 over the next 12 months. For Canadian securities we expect the stock to perform within 10% (plus or minus) of the S&P/TSX Composite Index. For other non-U.S. securities we expect the stock to perform within 10% (plus or minus) of the MSCI World Index. A Hold rating is also used for yield-sensitive securities where we are comfortable with the safety of the dividend, but believe that upside in the share price is limited.

SELL -For U.S. securities we expect the stock to underperform the S&P 500 by more than 10% over the next 12 months and believe the stock could decline in value. For Canadian securities we expect the stock to underperform the S&P/TSX Composite Index by more than 10% over the next 12 months and believe the stock could decline in value. For other non-U.S. securities we expect the stock to underperform the MSCI World Index by more than 10% over the next 12 months and believe the stock could decline in value.

Of the securities we rate, 48% are rated Buy, 50% are rated Hold, and 2% are rated Sell.

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