

BABSON CAPITAL PARTICIPATION INVESTORS

Form N-30D

May 30, 2013

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**Adviser**

Babson Capital Management LLC  
1500 Main Street, P.O. Box 15189  
Springfield, Massachusetts 01115-5189

**Transfer Agent & Registrar**

DST Systems, Inc.  
P.O. Box 219086  
Kansas City, MO 64121-9086  
1-800-647-7374

**Independent Registered Public Accounting Firm**

KPMG LLP  
Boston, Massachusetts 02110

**Internet Website**

[www.babsoncapital.com/mpv](http://www.babsoncapital.com/mpv)

**Counsel to the Trust**

Ropes & Gray LLP  
Boston, Massachusetts 02110

Babson Capital Participation Investors  
c/o Babson Capital Management LLC  
1500 Main Street, Suite 2200  
Springfield, Massachusetts 01115  
(413) 226-1516

**Custodian**

State Street Bank and Trust Company  
Boston, Massachusetts 02116

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**Investment Objective and Policy**

Babson Capital Participation Investors (the “Trust”) is a closed-end management investment company, first offered to the public in 1988, whose shares are traded on the New York Stock Exchange under the trading symbol “MPV”. The Trust’s share price can be found in the financial section of most newspapers under either the New York Stock Exchange listings or Closed-End Fund Listings.

The Trust’s investment objective is to maximize total return by providing a high level of current income, the potential for growth of income, and capital appreciation. The Trust’s principal investments are privately placed, below-investment grade, long-term debt obligations purchased directly from their issuers, which tend to be smaller companies. At least half of these investments normally include equity features such as common stock, warrants, conversion rights, or other equity features that provide the Trust with the opportunity to realize capital gains. The Trust will also invest in publicly traded debt securities (including high yield securities), again with an emphasis on those with equity features, and in convertible preferred stocks and, subject to certain limitations, readily marketable equity securities. Below-investment grade or high yield securities have predominantly speculative characteristics with respect to the capacity of the issuer to pay interest and repay principal. In addition, the Trust may temporarily invest in high quality, readily

**Form N-Q**

The Trust files its complete schedule of portfolio holdings with the U.S. Securities and Exchange Commission (“SEC”) for the first and third quarters of each fiscal year on Form N-Q. This information is available (i) on the SEC’s website at <http://www.sec.gov>; and (ii) at the SEC’s Public Reference Room in Washington, DC (which information on their operation may be obtained by calling 1-800-SEC-0330). A complete schedule of portfolio holdings as of each quarter-end is available upon request by calling, toll-free, 866-399-1516.

**Proxy Voting Policies & Procedures; Proxy Voting Record**

The Trustees of the Trust have delegated proxy voting responsibilities relating to the voting of securities held by the Trust to Babson Capital. A description of Babson Capital’s proxy voting policies and procedures is available (1) without charge, upon request, by calling, toll-free 866-399-1516; (2) on the Trust’s website: <http://www.babsoncapital.com/mpv>; and (3) on the SEC’s website at <http://www.sec.gov>. Information regarding how the Trust voted proxies relating to portfolio securities during the most recent 12-month period ended June 30 is available (1) on the Trust’s website: <http://www.babsoncapital.com/mpv>; and (2) on the SEC’s website at <http://www.sec.gov>.

marketable securities.

Babson Capital Management LLC (“Babson Capital”) manages the Trust on a total return basis. The Trust distributes substantially all of its net income to shareholders each year. Accordingly, the Trust pays dividends to shareholders in January, May, August, and November. All registered shareholders are automatically enrolled in the Dividend Reinvestment and Cash Purchase Plan unless cash distributions are requested.

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Babson Capital Participation Investors

TO OUR SHAREHOLDERS

April 30, 2013

We are pleased to present the March 31, 2013 Quarterly Report of Babson Capital Participation Investors (the "Trust").

The Board of Trustees declared a quarterly dividend of 27 cents per share, payable on May 10, 2013 to shareholders of record on April 29, 2013. The Trust paid a 27 cent per share dividend for the preceding quarter. The Trust earned 26 cents per share of net investment income for the first quarter of 2013, compared to 31 cents per share in the previous quarter, of which approximately \$0.05 per share represented income due to nonrecurring items.

During the first quarter, the net assets of the Trust increased to \$133,137,561 or \$13.05 per share compared to \$127,874,125 or \$12.56 per share on December 31, 2012. This translates into a 3.9% total return for the quarter, based on the change in the Trust's net assets assuming the reinvestment of all dividends. Longer term, the Trust returned 17.8%, 15.6%, 9.8%, and 14.2% for the 1-, 3-, 5-, and 10-year time periods, respectively, based on the change in the Trust's net assets assuming the reinvestment of all dividends.

The Trust's share price increased 3.2% during the quarter, from \$13.91 per share as of December 31, 2012 to \$14.35 per share as of March 31, 2013. The Trust's market price of \$14.35 per share equates to a 10.0% premium over the March 31, 2013 net asset value per share of \$13.05. The Trust's average quarter-end premium for the 3, 5 and 10-year periods was 18.1%, 10.1% and 10.6%, respectively. U.S. equity markets, as approximated by the Russell 2000 Index, increased 12.4% for the quarter. U.S. fixed income markets, as approximated by the Barclays Capital U.S. Corporate High Yield Index, increased 2.9% for the quarter.

The Trust closed two new private placement investments and one "follow-on" investment in an existing portfolio company during the first quarter. The two new investments were in gloProfessional Holdings, Inc. and Signature Systems Holdings Company, while the follow-on investment was in Synteract Holdings Corporation. A brief description of these investments can be found in the Consolidated Schedule of Investments. The total amount invested by the Trust in these transactions was \$2,419,000.

After a very busy fourth quarter of 2012, U.S. middle market buyout activity in the first quarter of 2013 was sluggish at best. Many market participants do expect deal flow to improve throughout the rest of the year as there continues to be an abundance of debt and equity capital available to be invested. We saw a significant increase in deal flow in the latter part of the first quarter which has continued into the second quarter. As a result, we expect the level of new investment activity in the second quarter to exceed the first quarter's pace.

The condition of the Trust's existing portfolio remained strong through the first quarter. We are pleased that sales and earnings for the Trust's portfolio as a whole continued their upward momentum. We had two companies exit the portfolio in the first quarter. Both companies, EXC Acquisition Corporation and HGGC Citadel Plastic Holdings, were successful investments for the Trust. We continue to have a healthy backlog of companies in the process of being sold and expect 2013 to be a good year for realizations. On the negative side of the ledger, however, we saw an unprecedented level of refinancing activity in the portfolio in the first quarter of 2013 and continuing into the second quarter. These transactions, in which the debt instruments held by the Trust were fully or partially prepaid, are being driven by companies seeking to take advantage of low interest rates and plentiful credit. We had eight portfolio companies fully or partially prepay the Trust's debt holdings in the first quarter, with another three companies prepaying their debt already in the second quarter. As mentioned in prior reports, the loss of these income-producing investments, unless replaced by new investments, could adversely affect the Trust's ability to sustain its dividend level

in the quarters ahead.

(Continued)

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At the Trust's Annual Meeting on April 19, 2013, shareholders approved the conversion of the Trust's investment objective from fundamental to non-fundamental. This change increases the investment flexibility of the Trust by permitting the Board of Trustees to react to changing market conditions and other developments by modifying the Trust's investment objective without shareholder approval, thereby avoiding the delay and expense associated with a proxy solicitation.

Lastly, on behalf of the Trust's shareholders, the members of the Board of Trustees, and the officers of the Trust, I would like to thank Donald Benson and Donald Glickman for their many years of service to the Trust as Trustees. Don Benson was elected as a Trustee in 1988, while Don Glickman was elected as a Trustee in 1992. The April 2013 meeting was their last meeting as Trustees. Both of them have provided the Trust with invaluable insight and guidance, and have served our shareholders extremely well throughout their tenure as Trustees. We will miss both of them and their contributions to the Trust.

Thank you for your continued interest in and support of Babson Capital Participation Investors.

Sincerely,

Michael L. Klofas  
President

\* Based on market value of total investments (including cash)

Cautionary Notice: Certain statements contained in this report may be "forward looking" statements. Investors are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date on which they are made and which reflect management's current estimates, projections, expectations or beliefs, and which are subject to risks and uncertainties that may cause actual results to differ materially. These statements are subject to change at any time based upon economic, market or other conditions and may not be relied upon as investment advice or an indication of the Trust's trading intent. References to specific securities are not recommendations of such securities, and may not be representative of the Trust's current or future investments. We undertake no obligation to publicly update forward looking statements, whether as a result of new information, future events, or otherwise.

CONSOLIDATED STATEMENT OF ASSETS AND LIABILITIES Babson Capital Participation Investors  
 March 31, 2013  
 (Unaudited)

## Assets:

## Investments

(See Consolidated Schedule of Investments)

Corporate restricted securities at fair value (Cost - \$103,262,162)	\$ 97,006,412
Corporate restricted securities at market value (Cost - \$6,635,709)	6,964,781
Corporate public securities at market value (Cost - \$25,982,751)	28,010,172
Short-term securities at amortized cost	10,499,296
Total investments (Cost - \$146,379,918)	142,480,661
Cash	6,660,446
Interest receivable	2,078,300
Other assets	23,829

Total assets	151,243,236
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## Liabilities:

Note payable	15,000,000
Payable for investments purchased	1,870,880
Deferred tax liability	604,376
Investment advisory fee payable	299,560
Tax payable	149,095
Interest payable	27,267
Accrued expenses	154,497

Total liabilities	18,105,675
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Total net assets	\$ 133,137,561
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## Net Assets:

Common shares, par value \$.01 per share	\$ 101,991
Additional paid-in capital	95,178,060
Retained net realized gain on investments, prior years	33,733,164
Undistributed net investment income	4,190,123
Accumulated net realized gain on investments	4,437,856
Net unrealized depreciation of investments	(4,503,633 )

Total net assets	\$ 133,137,561
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Common shares issued and outstanding (14,785,750 authorized)	10,199,121
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Net asset value per share	\$ 13.05
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See Notes to Consolidated Financial Statements

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## CONSOLIDATED STATEMENT OF OPERATIONS

For the three months ended March 31, 2013

(Unaudited)

Investment Income:	
Interest	\$3,256,911
Other	68,473
Total investment income	3,325,384
Expenses:	
Investment advisory fees	299,560
Interest	153,375
Trustees' fees and expenses	84,000
Professional fees	55,200
Reports to shareholders	22,500
Custodian fees	7,500
Other	6,250
Total expenses	628,385
Investment income - net	2,696,999
Net realized and unrealized gain on investments:	
Net realized gain on investments before taxes	761,148
Income tax expense	(1,572 )
Net realized gain on investments after taxes	759,576
Net change in unrealized depreciation of investments before taxes	1,728,065
Net change in deferred income tax expense	(136,742 )
Net change in unrealized depreciation of investments after taxes	1,591,323
Net gain on investments	2,350,899
Net increase in net assets resulting from operations	\$5,047,898

See Notes to Consolidated Financial Statements

## CONSOLIDATED STATEMENT OF CASH FLOW

Babson Capital Participation Investors

For the three months ended March 31, 2013

(Unaudited)

Net increase in cash:

Cash flows from operating activities:

Purchases/Proceeds/Maturities from short-term portfolio securities, net	\$(2,995,285 )
Purchases of portfolio securities	(3,060,669 )
Proceeds from disposition of portfolio securities	10,830,711
Interest, dividends and other income received	2,397,452
Interest expense paid	(153,375 )
Operating expenses paid	(457,465 )
Income taxes paid	(918,072 )
Net cash provided by operating activities	5,643,297

Cash flows from financing activities:

Cash dividends paid from net investment income	(2,749,477 )
Receipts for shares issued on reinvestment of dividends	215,538
Net cash used for financing activities	(2,533,939 )

Net increase in cash 3,109,358Cash - beginning of year 3,551,088Cash - end of period \$6,660,446

Reconciliation of net increase in net assets to net cash provided by operating activities:

Net increase in net assets resulting from operations	\$5,047,898
Decrease in investments	390,173
Increase in interest receivable	(946,426 )
Decrease in other assets	42,985
Increase in payable for investments purchased	1,870,880
Increase in deferred tax liability	136,742
Increase in investment advisory fee payable	11,843
Decrease in tax payable	(916,500 )
Increase in accrued expenses	5,702
Total adjustments to net assets from operations	595,399
Net cash provided by operating activities	\$5,643,297

See Notes to Consolidated Financial Statements

## CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS

	For the three months ended 03/31/2013 (Unaudited)	For the year ended 12/31/2012
Increase in net assets:		
Operations:		
Investment income - net	\$ 2,696,999	\$ 10,965,123
Net realized gain on investments after taxes	759,576	2,488,796
Net change in unrealized depreciation of investments after taxes	1,591,323	4,059,101
Net increase in net assets resulting from operations	5,047,898	17,513,020
Increase from common shares issued on reinvestment of dividends		
Common shares issued (2013 - 15,872; 2012 - 71,363)	215,538	1,013,772
Dividends to shareholders from:		
Net investment income (2013 - \$0.00 per share; 2012 - \$1.04 per share)	-	(10,584,312 )
Net realized gains (2013 - \$0.00 per share; 2012 - \$0.04 per share)	-	(388,021 )
Total increase in net assets	5,263,436	7,554,459
Net assets, beginning of year	127,874,125	120,319,666
Net assets, end of period/year (including undistributed net investment income of \$4,190,123 and \$1,493,124, respectively)	\$ 133,137,561	\$ 127,874,125

See Notes to Consolidated Financial Statements

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## CONSOLIDATED SELECTED FINANCIAL HIGHLIGHTS

Babson Capital Participation Investors

Selected data for each share of beneficial interest outstanding:

	For the three months ended 03/31/2013 (Unaudited)	For the years ended December 31,					2009	2008
		2012	2011	2010				
Net asset value:								
Beginning of year	\$ 12.56	\$ 11.90	\$ 11.89	\$ 10.91	\$ 11.10	\$ 12.84		
Net investment income (a)	0.26	1.08	1.14	1.02	0.94	1.08		
Net realized and unrealized gain (loss) on investments	0.23	0.64	0.08	0.95	(0.13 )	(1.82 )		
Total from investment operations	0.49	1.72	1.22	1.97	(0.81 )	0.74		
Dividends from net investment income to common shareholders	-	(1.04 )	(1.23 )	(1.00 )	(1.00 )	(1.00 )		
Dividends from net realized gain on investments to common shareholders	-	(0.04 )	(0.00 )	(b) -	-	-		
Increase from dividends reinvested	-	0.02	0.02	0.01	0.00	0.00		
Total dividends	-	(1.06 )	(1.21 )	(0.99 )	(1.00 )	(1.00 )		
Net asset value: End of period/year	\$ 13.05	\$ 12.56	\$ 11.90	\$ 11.89	\$ 10.91	\$ 11.10		
Per share market value: End of period/year	\$ 14.35	\$ 13.91	\$ 15.85	\$ 13.88	\$ 12.20	\$ 9.05		
Total investment return								
Net asset value (c)	3.90 %	15.89 %	10.56 %	18.71 %	7.60 %	(6.01 %)		
Market value (c)	3.16 %	(4.54 %)	24.16 %	22.94 %	40.86 %	(25.36 %)		
Net assets (in millions):								
End of period/year	\$ 133.14	\$ 127.87	\$ 120.32	\$ 119.54	\$ 108.93	\$ 110.18		
Ratio of operating expenses to average net assets	1.48 %	(e) 1.51 %	1.42 %	1.46 %	1.41 %	1.33 %		
Ratio of interest expense to average net assets	0.48 %	(e) 0.49 %	0.56 %	0.61 %	0.63 %	0.58 %		
Ratio of income tax expense to average net assets (d)	0.00 %	(e) 0.83 %	0.20 %	0.46 %	0.00 %	0.00 %		
Ratio of net expenses to average net assets	1.97 %	(e) 2.83 %	2.18 %	2.53 %	2.04 %	1.91 %		
Ratio of net investment income to average net assets	8.42 %	(e) 8.82 %	9.33 %	8.96 %	8.55 %	8.74 %		

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Portfolio turnover            4            %        34            %        21            %        27            %        23            %        32            %

(a) Calculated using average shares.

(b) Rounds to less than \$0.01 per share.

(c) Net asset value return represents portfolio returns based on change in the Trust's net asset value assuming the reinvestment of all dividends and distributions which differs from the total investment return based on the Trust's market value due to the difference between the Trust's net asset value and the market value of its shares outstanding; past performance is no guarantee of future results.

(d) As additional information, this ratio is included to reflect the taxes paid on retained long-term gains. These taxes paid are netted against realized capital gains in the Statement of Operations. The taxes paid are treated as deemed distributions and a credit for the taxes paid is passed on to shareholders.

(e) Annualized

Senior borrowings:

Total principal amount (in millions)	\$15	\$15	\$15	\$12	\$12	\$12
Asset coverage per \$1,000 of indebtedness	\$9,876	\$9,525	\$9,021	\$10,962	\$10,077	\$10.181

See Notes to Consolidated Financial Statements

## CONSOLIDATED SCHEDULE OF INVESTMENTS

March 31, 2013

(Unaudited)

## Babson Capital Participation Investors

	Principal Amount, Shares, Units or Ownership Percentage	Acquisition Date	Cost	Fair Value
Corporate Restricted Securities - 78.09%: (A)				
Private Placement Investments - 72.86%				
1492 Acquisition LLC				
A leading producer of premium Italian cured meats and deli meats in the U.S.				
14% Senior Subordinated Note due 2019	\$1,146,677	10/17/12	\$1,124,848	\$1,127,435
Limited Liability Company Unit Class A Common (B)	11,364 uts.	10/17/12	11,364	10,873
Limited Liability Company Unit Class A Preferred (B)	102 uts.	10/17/12	102,270	103,974
			1,238,482	1,242,282
A E Company, Inc.				
A designer and manufacturer of machined parts and assembly structures for the commercial and military aerospace industries.				
	184,615			
Common Stock (B)	shs.	11/10/09	184,615	403,583
Warrant, exercisable until 2019, to purchase common stock at \$.01 per share (B)	92,308 shs.	11/10/09	68,566	201,793
			253,181	605,376
A H C Holding Company, Inc.				
A designer and manufacturer of boilers and water heaters for the commercial sector.				
Limited Partnership Interest (B)	12.26% int.	11/21/07	119,009	150,975
A S C Group, Inc.				
A designer and manufacturer of high reliability encryption equipment, communications products, computing systems and electronic components primarily for the military and aerospace sectors.				
Limited Liability Company Unit Class A (B)	2,186 uts.	*	78,340	87,388
Limited Liability Company Unit Class B (B)	1,479 uts.	10/09/09	52,999	59,125
* 10/09/09 and 10/27/10.			131,339	146,513
A W X Holdings Corporation				
A provider of aerial equipment rental, sales and repair services to non-residential construction and maintenance contractors operating in the state of Indiana.				
10.5% Senior Secured Term Note due 2014 (D)	\$420,000	05/15/08	413,944	315,000
13% Senior Subordinated Note due 2015 (D)	\$420,000	05/15/08	384,627	-
Common Stock (B)	60,000 shs.	05/15/08	60,000	-
Warrant, exercisable until 2015, to purchase common stock at \$.01 per share (B)	21,099 shs.	05/15/08	35,654	-
			894,225	315,000

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ABC Industries, Inc.

A manufacturer of mine and tunneling ventilation products in the U.S.

13% Senior Subordinated Note due 2019	\$500,000	08/01/12	450,515	495,961
Preferred Stock Series A (B)	125,000 shs.	08/01/12	125,000	112,785
Warrant, exercisable until 2022, to purchase				