

BABSON CAPITAL PARTICIPATION INVESTORS

Form N-CSR

March 11, 2013

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM N-CSR

CERTIFIED SHAREHOLDER REPORT OF REGISTERED MANAGEMENT  
INVESTMENT COMPANIES

Investment Company Act file number 811-5531

Babson Capital Participation Investors

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(Exact name of registrant as specified in charter)

1500 Main Street, P.O. Box 15189, Springfield, MA 01115-5189

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(Address of principal executive offices) (Zip code)

Christopher A. DeFrancis, Vice President and Secretary

1500 Main Street, Suite 2800, P.O. Box 15189, Springfield, MA 01115-5189

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(Name and address of agent for service)

Registrant's telephone number, including area code: 413-226-1000

Date of fiscal year end: 12/31

Date of reporting period: 12/31/12

Form N-CSR is to be used by management investment companies to file reports with the Commission not later than 10 days after the transmission to stockholders of any report that is required to be transmitted to stockholders under Rule 30e-1 under the Investment Company Act of 1940 (17 CFR 270.30e-1). The Commission may use the information provided on Form N-CSR in its regulatory, disclosure review, inspection and policymaking roles.

A registrant is required to disclose the information specified by Form N-CSR, and the Commission will make this information public. A registrant is not required to respond to the collection of information contained in Form N-CSR unless the Form displays a currently valid Office of Management and Budget ("OMB") control number. Please direct

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comments concerning the accuracy of the information collection burden estimate and any suggestions for reducing the burden to Secretary, Securities and Exchange Commission, 110 F Street NE, Washington, DC 20549. The OMB has reviewed this collection of information under the clearance requirements of 44 U.S.C. ss. 3507.

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ITEM 1. REPORT TO STOCKHOLDERS.

Attached hereto is the annual shareholder report transmitted to shareholders pursuant to Rule 30e-1 of the Investment Company Act of 1940, as amended.





## BABSON CAPITAL PARTICIPATION INVESTORS

Babson Capital Participation Investors is a closed-end investment company, first offered to the public in 1988, whose shares are traded on the New York Stock Exchange.

### INVESTMENT OBJECTIVE & POLICY

Babson Capital Participation Investors (the “Trust”) is a closed-end 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 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 (as defined below), 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 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. The Trust is prohibited from purchasing below-investment grade securities if, after giving effect to the purchase, more than 75% of the Trusts’ total assets would be invested in below-investment grade securities, which are securities that are rated, at the time of purchase, BB or B by S&P or Ba or B by Moody’s, or, if unrated, are believed by Babson Capital Management LLC (“Babson Capital”) to be of an equivalent quality. In addition, the Trust will not invest in any debt security that is rated, at the time of acquisition, below B by S&P or Moody’s, or if unrated, is believed by Babson Capital to be of an equivalent quality. In addition, the Trust may temporarily invest in high quality, readily marketable securities.

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 four times a year 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.

In this report you will find a complete listing of the Trust’s holdings. We encourage you to read this section carefully for a better understanding of the Trust. We cordially invite all shareholders to attend the Trust’s Annual Meeting of Shareholders, which will be held on April 19, 2013 at 1:00 P.M. in Springfield, Massachusetts.

Babson Capital Participation Investors

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\*Data for Babson Capital Participation Investors (the “Trust”) represents portfolio returns based on change in the Trust’s net asset value assuming the reinvestment of all dividends and distributions. These returns differ from the total investment return based on market value of the Trust’s shares due to the difference between the Trust’s net asset value and the market value of its shares outstanding (see page 12 for total investment return based on market value). Past performance is no guarantee of future results.

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## 2012 Annual Report

## TO OUR SHAREHOLDERS

I am pleased to share with you the Trust's Annual Report for the year ended December 31, 2012.

## PORTFOLIO PERFORMANCE

The Trust's net total portfolio rate of return for 2012 was 15.9%, as measured by the change in net asset value and assuming the reinvestment of all dividends and distributions. The Trust's total net assets were \$127,874,125, or \$12.56 per share, as of December 31, 2012. This compares to \$120,319,666 or \$11.90 per share, as of December 31, 2011. The Trust paid a quarterly dividend of \$0.27 per share for each of the four quarters of 2012, for a total annual dividend of \$1.08 per share. In 2011, the Trust also paid four quarterly dividends of \$0.27 per share, and declared a special year-end dividend of \$0.15 per share, for a total annual dividend of \$1.23 per share. Net investment income for the year was \$1.08 per share, including approximately \$0.06 per share of non-recurring income. Net investment income for 2011 was \$1.14 per share, which included approximately \$0.12 per share of non-recurring income.

After increasing 14.2% in 2011 and 13.8% in 2010, the Trust's stock price declined from \$15.85 as of December 31, 2011 to \$13.91 as of December 31, 2012, or 12.2%. Since year-end, the stock price has rebounded nicely. The Trust's stock price of \$13.91 as of December 31, 2012 equates to a 10.7% premium over the December 31, 2012 net asset value per share of \$12.56. The Trust's average quarter-end premium for the 3, 5 and 10-year periods was 18.3%, 9.7% and 10.5%, respectively.

The table below lists the average annual net returns of the Trust's portfolio, based on the change in net assets and assuming the reinvestment of all dividends and distributions. Average annual returns of the Barclays Capital U.S. Corporate High Yield Index and the Russell 2000 Index for the 1, 3, 5 and 10 years ended December 31, 2012 are provided for comparison purposes only.

## PORTFOLIO ACTIVITY

|          | The Trust | Barclays Capital U.S.<br>Corporate High Yield<br>Index | Russell<br>2000 Index |
|----------|-----------|--|-----------------------|
| 1 Year   | 15.89%    | 15.81%   | 16.35%                |
| 3 Years  | 15.01%    | 11.86%   | 12.25%                |
| 5 Years  | 9.00%     | 10.34%   | 3.56%                 |
| 10 Years | 14.30%    | 10.62%   | 9.72%                 |

Past performance is no guarantee of future results.



Babson Capital Participation Investors

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New investment activity for the Trust was strong in 2012, particularly in the fourth quarter when the Trust completed 11 new private placement investments and one add-on investment. For the full year 2012, the Trust closed 21 new private placement investments and 11 add-on investments in nine existing portfolio companies. Total private placement investments purchased in 2012 were \$23,001,545. This amount represents an 85.6% increase from the \$12,396,081 of new private placement investments completed by the Trust in 2011. We were certainly pleased with the quantity of new investment activity in 2012, but, more importantly, we were very pleased by the overall quality of these new investments. Leverage multiples were reasonable during the year and pricing and return expectations on new investments were at an acceptable level in 2012. All in all, market conditions in the private mezzanine investment arena in 2012 were favorable for new investment activity.

New private placement investments completed during 2012 were 1492 Acquisition LLC; ABC Industries, Inc.; Advanced Manufacturing Enterprises; AMS Holding LLC; Baby Jogger Holdings LLC; BP SCI LLC; Blue Wave Products, Inc.; Church Services Holding Company; DPL Holding Corporation; ELT Holding Company; GD Dental Services LLC; Healthcare Direct Holding Company; HGGC Citadel Plastics Holdings; HVAC Holdings, Inc.; JMH Investors LLC; MNX Holding Company; Petroplex Inv Holdings LLC; RM Holding Company; Rose City Holding Co.; Safety Infrastructure Solutions and Stag Parkway Holding Co. In addition, the Trust added to existing private placement investments in CHG Alternative Education Holding Company; Church Services Holding Company; DPC Holdings LLC; DPL Holding Corporation; FCX Holding Corporation; FGI Equity LLC; LPC Holding Company; LTS Scale and Merex Holding Corporation. A brief description of these investments can be found in the Consolidated Schedule of Investments.

The condition of the Trust's existing portfolio continued to strengthen in 2012. Sales and earnings for the Trust's portfolio as a whole continued their upward momentum – we now have seen 34 consecutive months of increases in the average sales and EBITDA of our portfolio companies since hitting trough levels in late 2009. Credit upgrades in the portfolio this year once again far outnumbered credit downgrades, while the number of companies on our watch list and in default is at the lowest level we have seen over the last five years.

We had 19 companies exit from the Trust's portfolio during 2012. In 17 of these exits, the Trust realized a significant positive return on its investment. These investments were ASAP Industries LLC; Aero Holdings, Inc.; Associated Diversified Services; Barcodes Group, Inc.; Coeur, Inc.; FCX Holding Corporation; FH Equity LLC, Milwaukee Gear Company; Nyloncraft, Inc.; Oak River Technology, Inc.; Power Services Holding Company; REI Delaware Holdings, Inc.; Royal Baths Manufacturing Company; Savage Sports Holding, Inc.; Stanton Carpet Holding Company; THI Acquisition, Inc. and Xaloy Superior Holdings, Inc. Two long-standing troubled investments, KWPI Holdings Corporation and Pacific Consolidated Holdings LLC, were also realized in 2012 at recovery levels consistent with their carrying values. In addition, we had a number of companies who took advantage of lower interest rate and improved operating performance to refinance and prepay their debt obligations to the Trust.

## OUTLOOK FOR 2013

Though the mergers and acquisitions market has taken a bit of a breather in early 2013, we expect that deal flow will pick up and be at robust levels during the rest of 2013. This should lead to a healthy level of investment opportunities for the Trust. We also have a significant number of portfolio companies that are in various stages of a sale process, and we expect that realization activity will remain strong in 2013. Strong realization and refinancing activity is a double-edged sword, however, as the resulting loss of income-producing investments could adversely impact the Trust's ability to sustain its dividend level. We have been fortunate that our new investment activity in recent years has been strong and has had a positive impact on net investment income. We will need to maintain a robust level of new investment activity in the face of expected high levels of realization and refinancing activity.

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## 2012 Annual Report

The Trust performed well in 2012. Despite the unsettled global economic conditions and other challenges, we are optimistic about the Trust's performance as we proceed through 2013. Rest assured that regardless of the economic and market environment, the Trust will continue to employ the investment philosophy that has served it well since its inception: investing in companies which we believe have a strong business proposition, solid cash flow and experienced, ethical management. This philosophy, along with Babson Capital's seasoned investment-management team, positions the Trust well to meet its investment objectives and policies. As always, I would like to thank you for your continued interest in and support of Babson Capital Participation Investors. I look forward to seeing you at the Trust's annual shareholder meeting in Springfield on April 19, 2013.

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 Martin T. Hart for his over 21 years of dedicated service to the Trust as a Trustee. Martin was elected as a Trustee in April 1991 and the December 2012 meeting of the Trustees was his last meeting as a Trustee. He has provided the Trust with unique and invaluable insight and guidance throughout his tenure as a Trustee. We will miss him and his contributions to the Trust.

Sincerely,  
Michael L. Klofas  
President

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 in 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.

|           | Record     | Net        | Short-Term | Tax       | Long-Term |
|-----------|------------|------------|------------|-----------|-----------|
| 2012      | Date       | Investment | Gains      | Effect    | Gains     |
| Dividends |            | Income     |            |           |           |
| Regular   | 5/7/2012   | 0.2700     | -          |           | -         |
|           | 7/30/2012  | 0.2700     | -          |           | -         |
|           | 10/29/2012 | 0.2700     | -          |           | -         |
|           | 12/31/2012 | 0.2319     | 0.0381     | -         | -         |
|           |            | \$ 1.0419  | \$ 0.0381  | \$ 1.0800 | 0.0000    |

The following table summarizes the tax effects of the relation of capital gains for 2012:

|                          | Amount    | Form 2439 |
|--------------------------|-----------|-----------|
|                          | Per Share | Line 1a   |
| 2012 Gains Retained      | 0.2571    | Line 1a   |
| Long-Term Gains Retained | 0.2571    |           |
| Taxes Paid               | 0.0900    | Line 2 *  |
| Basis Adjustment         | 0.1671    | **        |

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If you are not subject to federal capital gains tax (e.g. charitable organizations, IRAs and Keogh Plans) you may be able to claim a refund by filing Form 990-T.

\*\* For federal income tax purposes, you may increase the adjusted cost basis of your shares by this amount (the excess of Line 1a over Line 2).

| Annual Dividend Amount Per Share | Qualified For Dividend Received Deduction*** | Qualified Dividends**** | Interest Earned On U.S. Gov't. Obligations |
|----------------------------------|--|-------------------------|--|
|                                  | Amount Per Share                             | Amount Per Share        | Amount Per Share                           |
|                                  | Percent                                      | Percent                 | Percent                                    |
| \$1.08                           | 6.5233 %                                     | 0.0703                  | 0  |
|                                  |  | 6.2241 %                | 0.0000                                     |
|                                  |  | 0.0671                  |  |

\*\*\*Not available to individual shareholders

\*\*\*\*Qualified dividends are reported in Box 1b on IRS Form 1099-Div for 2012



## 2012 Annual Report

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**CONSOLIDATED STATEMENT OF ASSETS AND LIABILITIES**  
 December 31, 2012

## Assets:

## Investments

(See Consolidated Schedule of Investments)

|   |                |
|---|----------------|
| Corporate restricted securities at fair value<br>(Cost - \$109,376,327) | \$ 101,530,328 |
| Corporate restricted securities at market value<br>(Cost - \$5,279,368) | 5,534,500      |
| Corporate public securities at market value<br>(Cost - \$26,343,135)    | 28,306,680     |
| Short-term securities at amortized cost                                 | 7,499,326      |
| Total investments (Cost - \$148,498,156)                                | 142,870,834    |
| Cash  | 3,551,088      |
| Interest receivable   | 1,131,874      |
| Other assets  | 66,814         |

|              |             |
|--------------|-------------|
| Total assets | 147,620,610 |
|--------------|-------------|

## Liabilities:

|                                 |            |
|---------------------------------|------------|
| Note payable                    | 15,000,000 |
| Dividend payable                | 2,749,477  |
| Tax Payable                     | 1,065,595  |
| Deferred tax liability          | 467,634    |
| Investment advisory fee payable | 287,717    |
| Interest payable                | 27,267     |
| Accrued expenses                | 148,795    |

|                   |            |
|-------------------|------------|
| Total liabilities | 19,746,485 |
|-------------------|------------|

|                  |                |
|------------------|----------------|
| Total net assets | \$ 127,874,125 |
|------------------|----------------|

## Net Assets:

|  |             |
|--|-------------|
| Common shares, par value \$.01 per share               | \$ 101,832  |
| Additional paid-in capital                             | 94,962,681  |
| Retained net realized gain on investments, prior years | 33,733,164  |
| Undistributed net investment income                    | 1,493,124   |
| Accumulated net realized gain on investments           | 3,678,280   |
| Net unrealized depreciation of investments             | (6,094,956) |

|                  |                |
|------------------|----------------|
| Total net assets | \$ 127,874,125 |
|------------------|----------------|

|  |            |
|--|------------|
| Common shares issued and outstanding (14,785,750 authorized) | 10,183,249 |
|--|------------|

|                           |          |
|---------------------------|----------|
| Net asset value per share | \$ 12.56 |
|---------------------------|----------|

See Notes to Consolidated Financial Statements

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## Babson Capital Participation Investors

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**CONSOLIDATED STATEMENT OF OPERATIONS**

For the year ended December 31, 2012

|   |                  |
|---|------------------|
| Investment Income:  |                  |
| Interest  | \$12,616,327     |
| Dividends   | 704,628          |
| Other   | 131,954          |
| <br>Total investment income                                       | <br>13,452,909   |
| Expenses:   |                  |
| Investment advisory fees  | 1,132,533        |
| Interest  | 613,500          |
| Trustees' fees and expenses                                       | 322,000          |
| Professional fees   | 231,700          |
| Reports to shareholders   | 54,000           |
| Custodian fees  | 28,000           |
| Other   | 106,053          |
| <br>Total expenses  | <br>2,487,786    |
| <br>Investment income - net                                       | <br>10,965,123   |
| Net realized and unrealized gain on investments:                  |                  |
| Net realized gain on investments before taxes                     | 3,515,717        |
| Income tax expense  | (1,026,921 )     |
| Net realized gain on investments after taxes                      | 2,488,796        |
| Net change in unrealized depreciation of investments before taxes | 4,024,607        |
| Net change in deferred income tax expense                         | 34,494           |
| Net change in unrealized depreciation of investments after taxes  | 4,059,101        |
| <br>Net gain on investments                                       | <br>6,547,897    |
| <br>Net increase in net assets resulting from operations          | <br>\$17,513,020 |

See Notes to Consolidated Financial Statements



## 2012 Annual Report

**CONSOLIDATED STATEMENT OF CASH FLOWS**

For the year ended December 31, 2012

|  |              |
|--|--------------|
| Net decrease in cash:  |              |
| Cash flows from operating activities:  |              |
| Purchases/Proceeds/Maturities from short-term portfolio securities, net                    | \$ 543,397   |
| Purchases of portfolio securities  | (44,067,920) |
| Proceeds from disposition of portfolio securities  | 44,374,220   |
| Interest, dividends and other income received  | 11,514,383   |
| Interest expense paid  | (616,908 )   |
| Operating expenses paid  | (1,911,382 ) |
| Income taxes paid  | 38,674       |
| Net cash provided by operating activities  | 9,874,464    |
| Cash flows from financing activities:  |              |
| Cash dividends paid from net investment income and realized short-term gains               | (12,469,848) |
| Receipts for shares issued on reinvestment of dividends                                    | 1,013,772    |
| Net cash used for financing activities   | (11,456,076) |
| Net decrease in cash   | (1,581,612 ) |
| Cash - beginning of year   | 5,132,700    |
| Cash - end of year   | \$3,551,088  |
| Reconciliation of net increase in net assets to net cash provided by operating activities: |              |
| Net increase in net assets resulting from operations                                       | \$17,513,020 |
| Increase in investments  | (8,827,872 ) |
| Decrease in interest receivable  | 146,273      |
| Increase in receivable for investments sold  | (66,814 )    |
| Decrease in other assets   | 119,260      |
| Increase in tax payable  | 1,065,595    |
| Decrease in deferred tax liability   | (34,494 )    |
| Increase in investment advisory fee payable  | 16,998       |
| Decrease in interest payable   | (3,408 )     |
| Decrease in accrued expenses   | (54,094 )    |
| Total adjustments to net assets from operations  | (7,638,556 ) |
| Net cash provided by operating activities  | \$9,874,464  |

See Notes to Consolidated Financial Statements

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## Babson Capital Participation Investors

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**CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS**  
 For the year ended December 31, 2012 and 2011

|   | 2012          | 2011          |
|---|---------------|---------------|
| Increase in net assets:   |               |               |
| Operations:   |               |               |
| Investment income - net   | \$10,965,123  | \$11,526,972  |
| Net realized gain on investments after taxes  | 2,488,796     | 627,341       |
| Net change in unrealized depreciation of investments after taxes  | 4,059,101     | 166,242       |
| Net increase in net assets resulting from operations  | 17,513,020    | 12,320,555    |
| Increase from common shares issued on reinvestment of dividends   |               |               |
| Common shares issued (2012 - 71,363; 2011 - 61,615)   | 1,013,772     | 871,579       |
| Dividends to shareholders from:   |               |               |
| Net investment income (2012 - \$1.04 per share; 2011 - \$1.23 per share)  | (10,584,312 ) | (12,387,295 ) |
| Net realized gains (2012 - \$0.04 per share; 2011 - \$0.00 per share)   | (388,021 )    | (25,408 )     |
| Total increase in net assets  | 7,544,459     | 779,431       |
| Net assets, beginning of year   | 120,319,666   | 119,540,235   |
| Net assets, end of year (including undistributed net investment income of \$1,493,124 and \$1,259,710 respectively) | \$127,874,125 | \$120,319,666 |

See Notes to Consolidated Financial Statements

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## 2012 Annual Report

**CONSOLIDATED SELECTED FINANCIAL HIGHLIGHTS**

Selected Data for each share of beneficial interest outstanding:

|  | For the years ended December 31, |             |           |           |           |
|--|----------------------------------|-------------|-----------|-----------|-----------|
|  | 2012                             | 2011        | 2010      | 2009      | 2008      |
| Net asset value:   |                                  |             |           |           |           |
| Beginning of year  | \$ 11.90                         | \$ 11.89    | \$ 10.91  | \$ 11.10  | \$ 12.84  |
| Net investment income (a)  | 1.08                             | 1.14        | 1.02      | 0.94      | 1.08      |
| Net realized and unrealized gain (loss) on investments                 | 0.64                             | 0.08        | 0.95      | (0.13 )   | (1.82 )   |
| Total from investment operations                                       | 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 (b ) | 0.00(b )  |
| Total dividends  | (1.06 )                          | (1.21 )     | (0.99 )   | (1.00 )   | (1.00 )   |
| Net asset value: End of year   | \$ 12.56                         | \$ 11.90    | \$ 11.89  | \$ 10.91  | \$ 11.10  |
| Per share market value:  |                                  |             |           |           |           |
| End of year  | \$ 13.91                         | \$ 15.85    | \$ 13.88  | \$ 12.20  | \$ 9.05   |
| Total investment return  |                                  |             |           |           |           |
| Net asset value (c)  | 15.89 %                          | 10.56 %     | 18.71 %   | 7.60 %    | (6.01 %)  |
| Market value (c)   | (4.54 %)                         | 24.16 %     | 22.94 %   | 40.86 %   | (25.36 %) |
| Net assets (in millions):  |                                  |             |           |           |           |
| End of year  | \$ 127.87                        | \$ 120.32   | \$ 119.54 | \$ 108.93 | \$ 110.18 |
| Ratio of operating expenses to average net assets                      | 1.51 %                           | 1.42 %      | 1.46 %    | 1.41 %    | 1.33 %    |
| Ratio of interest expense to average net assets                        | 0.49 %                           | 0.56 %      | 0.61 %    | 0.63 %    | 0.58 %    |
| Ratio of income tax expense to average net assets (d)                  | 0.83 %                           | 0.20 %      | 0.46 %    | 0.00 %    | 0.00 %    |
| Ratio of total expenses to average net assets                          | 2.83 %                           | 2.18 %      | 2.53 %    | 2.04 %    | 1.91 %    |
| Ratio of net investment income to average net assets                   | 8.82 %                           | 9.33 %      | 8.96 %    | 8.55 %    | 8.74 %    |
| Portfolio turnover   | 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.

Senior borrowings:

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|   |         |         |          |          |          |
|---|---------|---------|----------|----------|----------|
| Total principal amount (in millions)          | \$15    | \$15    | \$12     | \$12     | \$12     |
| Asset coverage per \$1,000<br>of indebtedness | \$9,525 | \$9,021 | \$10,962 | \$10,077 | \$10,181 |

See Notes to Consolidated Financial Statements

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## Babson Capital Participation Investors

## CONSOLIDATED SCHEDULE OF INVESTMENTS

December 31, 2012

|  | Principal<br>Amount,<br>Shares, Units<br>or<br>Ownership<br>Percentage | Acquisition<br>Date | Cost         | Fair Value   |
|--|--|---------------------|--------------|--------------|
| Corporate Restricted Securities - 83.73%: (A)  |  |                     |              |              |
| Private Placement Investments - 79.40%   |  |                     |              |              |
| 1492 Acquisition LLC   |  |                     |              |              |
| A leading producer of premium Italian cured meats and deli meats in the U.S.   |  |                     |              |              |
| 14% Senior Subordinated Note due 2019<br>Limited Liability Company Unit Class A<br>Common (B)  | \$ 1,140,973   | 10/17/12            | \$ 1,118,647 | \$ 1,135,544 |
| Limited Liability Company Unit Class A<br>Preferred (B)  | 11,364 uts.  | 10/17/12            | 11,364       | 10,795       |
|  | 102 uts.   | 10/17/12            | 102,270      | 97,157       |
|  |  |                     | 1,232,281    | 1,243,496    |
| A E Company, Inc.  |  |                     |              |              |
| A designer and manufacturer of machined parts and assembly structures for the commercial and military aerospace industries.  |  |                     |              |              |
| Common Stock (B)   | 184,615 shs.   | 11/10/09            | 184,615      | 183,895      |
| Warrant, exercisable until 2019, to purchase<br>common stock at \$.01 per share (B)  | 92,308 shs.  | 11/10/09            | 68,566       | 91,948       |
|  |  |                     | 253,181      | 275,843      |
| A H C Holding Company, Inc.  |  |                     |              |              |
| A designer and manufacturer of boilers and water heaters for the commercial sector.  |  |                     |              |              |
| 15% Senior Subordinated Note due 2015  | \$ 1,437,377   | 11/21/07            | 1,423,632    | 1,437,377    |
| Limited Partnership Interest (B)   | 12.26% int.  | 11/21/07            | 119,009      | 145,595      |
|  |  |                     | 1,542,641    | 1,582,972    |
| 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       | 244,764      |
| Limited Liability Company Unit Class B (B)   | 1,479 uts.   | 10/09/09            | 52,999       | 165,602      |
| * 10/09/09 and 10/27/10.   |  |                     | 131,339      | 410,366      |
| 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      | 378,000      |
| 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<br>common stock at \$.01 per share (B)  | 21,099 shs.  | 05/15/08            | 35,654       | -            |
|  |  |                     | 894,225      | 378,000      |

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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 | 449,373 | 502,196 |
| Preferred Stock Series A (B)  | 125,000 shs. | 08/01/12 | 125,000 | 98,544  |
| Warrant, exercisable until 2022, to purchase<br>common stock at \$.01 per share (B) | 22,414 shs.  | 08/01/12 | 42,446  | -       |
|   |              |          | 616,819 | 600,740 |

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## 2012 Annual Report

## CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)

December 31, 2012

| Corporate Restricted Securities: (A)<br>(Continued)  | Principal<br>Amount,<br>Shares, Units<br>or<br>Ownership<br>Percentage | Acquisition<br>Date | Cost      | Fair Value |
|--|--|---------------------|-----------|------------|
| <b>ACP Cascade Holdings LLC</b>  |  |                     |           |            |
| A manufacturer and distributor of vinyl windows and patio doors throughout the northwestern United States.           |  |                     |           |            |
| Limited Liability Company Unit Class B (B)   | 32 uts.  | 11/09/12            | \$ -      | \$ -       |
| <b>Advanced Manufacturing Enterprises LLC</b>  |  |                     |           |            |
| A designer and manufacturer of large, custom gearing products for a number of critical customer applications.        |  |                     |           |            |
| 14% Senior Subordinated Note due 2018  | \$ 1,136,065   | 12/07/12            | 1,119,171 | 1,134,707  |
| Limited Liability Company Unit (B)   | 1,154 uts.   | 12/07/12            | 115,385   | 109,616    |
|  |  |                     | 1,234,556 | 1,244,323  |
| <b>Advanced Technologies Holdings</b>  |  |                     |           |            |
| A provider of factory maintenance services to industrial companies.  |  |                     |           |            |
| Preferred Stock Series A (B)   | 421 shs.   | 12/27/07            | 208,456   | 684,435    |
| Convertible Preferred Stock Series B (B)   | 28 shs.  | 01/04/11            | 21,600    | 45,151     |
|  |  |                     | 230,056   | 729,586    |
| <b>All Current Holding Company</b>   |  |                     |           |            |
| A specialty re-seller of essential electrical parts and components primarily serving wholesale distributors.         |  |                     |           |            |
| 12% Senior Subordinated Note due 2015  | \$ 603,697   | 09/26/08            | 575,444   | 603,697    |
| Common Stock (B)   | 713 shs.   | 09/26/08            | 71,303    | 104,680    |
| Warrant, exercisable until 2018, to purchase<br>common stock at \$.01 per share (B)                                  | 507 shs.   | 09/26/08            | 46,584    | 74,436     |
|  |  |                     | 693,331   | 782,813    |
| <b>American Hospice Management Holding<br/>LLC</b>   |  |                     |           |            |
| A for-profit hospice care provider in the<br>United States.  |  |                     |           |            |
| 12% Senior Subordinated Note due 2013  | \$ 1,687,503   | *                   | 1,669,540 | 1,687,503  |
| Preferred Class A Unit (B)   | 1,706 uts.   | **                  | 170,600   | 342,965    |
| Preferred Class B Unit (B)   | 808 uts.   | 06/09/08            | 80,789    | 89,515     |
| Common Class B Unit (B)  | 16,100 uts.  | 01/22/04            | 1         | -          |
| Common Class D Unit (B)  | 3,690 uts.   | 09/12/06            | -         | -          |
| * 01/22/04 and 06/09/08.   |  |                     | 1,920,930 | 2,119,983  |
| ** 01/22/04 and 09/12/06.  |  |                     |           |            |
| <b>AMS Holding LLC</b>   |  |                     |           |            |
| A leading multi-channel direct marketer of high-value collectible coins and proprietary-branded jewelry and watches. |  |                     |           |            |
| 14.25% Senior Subordinated Note due 2019   | \$ 1,142,472   | 10/04/12            | 1,120,211 | 1,142,963  |
| Limited Liability Company Unit Class<br>A Preferred (B)  | 114 uts.   | 10/04/12            | 113,636   | 107,948    |



1,233,847

1,250,911

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## Babson Capital Participation Investors

## CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)

December 31, 2012

| Corporate Restricted Securities: (A) (Continued)   | Principal Amount, Shares, Units or Ownership Percentage | Acquisition Date | Cost      | Fair Value  |
|--|---|------------------|-----------|-------------|
| <b>Apex Analytix Holding Corporation</b>   |   |                  |           |             |
| A provider of audit recovery and fraud detection services and software to commercial and retail businesses in the U.S. and Europe. |   |                  |           |             |
| 12.5% Senior Subordinated Note due 2017  | \$1,012,500   | 04/28/09         | \$921,502 | \$1,012,500 |
| Preferred Stock Series B (B)   | 1,623 shs.  | 04/28/09         | 162,269   | 108,227     |
| Common Stock (B)   | 723 shs.  | 04/28/09         | 723       | 48,235      |
|  |   |                  | 1,084,494 | 1,168,962   |
| <b>Arch Global Precision LLC</b>   |   |                  |           |             |
| A leading manufacturer of high tolerance precision components and consumable tools.  |   |                  |           |             |
| 14.75% Senior Subordinated Note due 2018   | \$771,365   | 12/21/11         | 753,570   | 794,506     |
| Limited Liability Company Unit Class B (B)   | 28 uts.   | 12/21/11         | 28,418    | 39,523      |
| Limited Liability Company Unit Class C (B)   | 222 uts.  | 12/21/11         | 221,582   | 308,148     |
|  |   |                  | 1,003,570 | 1,142,177   |
| <b>Arrow Tru-Line Holdings, Inc.</b>   |   |                  |           |             |
| A manufacturer of hardware for residential and commercial overhead garage doors in North America.                                  |   |                  |           |             |
| 8% Senior Subordinated Note due 2014 (D)   | \$762,004   | 05/18/05         | 687,447   | 762,004     |
| Preferred Stock (B)  | 33 shs.   | 10/16/09         | 33,224    | -           |
| Common Stock (B)   | 263 shs.  | 05/18/05         | 263,298   | -           |
| Warrant, exercisable until 2014, to purchase common stock at \$.01 per share (B)   | 69 shs.   | 05/18/05         | 59,362    | -           |
|  |   |                  | 1,043,331 | 762,004     |
| <b>Baby Jogger Holdings LLC</b>  |   |                  |           |             |
| A designer and marketer of premium baby strollers and stroller accessories.  |   |                  |           |             |
| 14% Senior Subordinated Note due 2019  | \$937,525   | 04/20/12         | 920,262   | 965,651     |
| Common Stock (B)   | 754 shs.  | 04/20/12         | 75,376    | 108,183     |
|  |   |                  | 995,638   | 1,073,834   |
| <b>Blue Wave Products, Inc.</b>  |   |                  |           |             |
| A distributor of pool supplies.  |   |                  |           |             |
| 10% Senior Secured Term Note due 2018  | \$317,730   | 10/12/12         | 311,550   | 316,320     |
| 13% Senior Subordinated Note due 2019  | \$318,436   | 10/12/12         | 295,372   | 316,824     |
| Common Stock (B)   | 51,064 shs.   | 10/12/12         | 51,064    | 48,511      |
| Warrant, exercisable until 2022, to purchase common stock at \$.01 per share (B)   | 20,216 shs.   | 10/12/12         | 20,216    | 202         |
|  |   |                  | 678,202   | 681,857     |
| <b>BP SCI LLC</b>  |   |                  |           |             |

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A leading value-added distributor of branded pipes, valves, and fittings (PVF) to diversified end markets.

|  |             |          |           |           |
|--|-------------|----------|-----------|-----------|
| 14% Senior Subordinated Note due 2018      | \$1,046,065 | 10/17/12 | 1,025,697 | 1,041,560 |
| Limited Liability Company Unit Class A (B) | 417 uts.    | 10/17/12 | 41,667    | 39,584    |
| Limited Liability Company Unit Class B (B) | 167 uts.    | 10/17/12 | 166,666   | 158,337   |
|  |             |          | 1,234,030 | 1,239,481 |

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## 2012 Annual Report

## CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)

December 31, 2012

| Corporate Restricted Securities: (A) (Continued)  | Principal<br>Amount,<br>Shares,<br>Units or<br>Ownership<br>Percentage | Acquisition<br>Date | Cost        | Fair Value |
|---|--|---------------------|-------------|------------|
| <b>Bravo Sports Holding Corporation</b>   |  |                     |             |            |
| A designer and marketer of niche branded consumer products including canopies, trampolines, in-line skates, skateboards, and urethane wheels.   |  |                     |             |            |
| 12.5% Senior Subordinated Note due 2014   | \$1,207,902  | 06/30/06            | \$1,187,708 | \$603,951  |
| Preferred Stock Class A (B)   | 465 shs.   | 06/30/06            | 141,946     | 19,899     |
| Common Stock (B)  | 1 sh.  | 06/30/06            | 152         | -          |
| Warrant, exercisable until 2014, to purchase common stock at \$.01 per share (B)  | 164 shs.   | 06/30/06            | 48,760      | 6,993      |
|   |  |                     | 1,378,566   | 630,843    |
| <b>C D N T, Inc.</b>  |  |                     |             |            |
| A value-added converter and distributor of specialty pressure sensitive adhesives, foams, films, and foils.   |  |                     |             |            |
| 10.5% Senior Secured Term Note due 2014   | \$160,901  | 08/07/08            | 159,846     | 160,901    |
| 12.5% Senior Subordinated Note due 2015   | \$429,070  | 08/07/08            | 408,743     | 429,070    |
| Common Stock (B)  | 41,860 shs.  | 08/07/08            | 41,860      | 64,536     |
| Warrant, exercisable until 2018, to purchase common stock at \$.01 per share (B)  | 32,914 shs.  | 08/07/08            | 32,965      | 50,744     |
|   |  |                     | 643,414     | 705,251    |
| <b>Capital Specialty Plastics, Inc.</b>   |  |                     |             |            |
| A producer of desiccant strips used for packaging pharmaceutical products.  |  |                     |             |            |
| Common Stock (B)  | 55 shs.  | *                   | 252         | 515,888    |
| *12/30/97 and 05/29/99.   |  |                     |             |            |
| <b>CHG Alternative Education Holding Company</b>  |  |                     |             |            |
| A leading provider of publicly-funded, for profit pre-K-12 education services targeting special needs children at therapeutic day schools and "at risk" youth through alternative education programs. |  |                     |             |            |
| 13.5% Senior Subordinated Note due 2018   | \$733,914  | 01/19/11            | 698,949     | 755,931    |
| 14% Senior Subordinated Note due 2019   | \$189,066  | 08/03/12            | 185,452     | 192,571    |
| Common Stock (B)  | 375 shs.   | 01/19/11            | 37,500      | 38,315     |
| Warrant, exercisable until 2021, to purchase common stock at \$.01 per share (B)  | 295 shs.   | 01/19/11            | 29,250      | 30,118     |
|   |  |                     | 951,151     | 1,016,935  |
| <b>Church Services Holding Company</b>  |  |                     |             |            |
| A provider of diversified residential services to homeowners in Houston, Dallas, and Austin markets.  |  |                     |             |            |
| 14.5% Senior Subordinated Note due 2018   | \$406,120  | 03/26/12            | 393,602     | 418,303    |
| Common Stock (B)  | 1,327 shs.   | *                   | 132,700     | 151,083    |
| Warrant, exercisable until 2022, to purchase  |  |                     |             |            |

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|                                     |         |          |         |         |
|-------------------------------------|---------|----------|---------|---------|
| common stock at \$.01 per share (B) | 57 shs. | 03/26/12 | 5,740   | 6,490   |
| *03/26/12, 05/25/12 and 06/19/12.   |         |          | 532,042 | 575,876 |

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## Babson Capital Participation Investors

## CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)

December 31, 2012

| Corporate Restricted Securities:<br>(A) (Continued)  | Principal<br>Amount,<br>Shares, Units<br>or<br>Ownership<br>Percentage | Acquisition<br>Date | Cost       | Fair Value |
|--|--|---------------------|------------|------------|
| Clough, Harbour and Associates<br>An engineering service firm that<br>is located in Albany, NY.<br>Preferred Stock (B)   | 147 shs.   | 12/02/08            | \$ 146,594 | \$ 252,298 |
| Connecticut Electric, Inc.<br>A supplier and distributor of electrical products sold into the retail and<br>wholesale markets.<br>10% Senior Subordinated Note<br>due 2014 (D)                       | \$ 771,051   | 01/12/07            | 719,299    | 740,686    |
| Limited Liability Company Unit<br>Class A (B)  | 82,613 uts.  | 01/12/07            | 82,613     | 32,686     |
| Limited Liability Company Unit<br>Class C (B)  | 59,756 uts.  | 01/12/07            | 59,756     | 23,642     |
| Limited Liability Company Unit<br>Class D (B)  | 671,525 uts.   | 05/03/10            | -          | 265,687    |
| Limited Liability Company Unit<br>Class E (B)  | 1,102 uts.   | 05/03/10            | -          | 436        |
|  |  |                     | 861,668    | 1,063,137  |
| Connor Sport Court<br>International, Inc.<br>A designer and manufacturer of outdoor and indoor synthetic sports flooring and other temporary flooring<br>products.<br>Preferred Stock Series B-2 (B) | 9,081 shs.   | 07/05/07            | 370,796    | 908,072    |
| Preferred Stock Series C (B)   | 3,748 shs.   | 07/05/07            | 125,207    | 374,811    |
| Common Stock (B)   | 380 shs.   | 07/05/07            | 4          | 202        |
| Limited Partnership Interest (B)<br>*08/12/04 and 01/14/05.  | 6.88% int.   | *                   | 103,135    | -          |
|  |  |                     | 599,142    | 1,283,085  |
| CorePharma LLC<br>A manufacturer of oral dose generic pharmaceuticals targeted at niche applications.<br>Warrant, exercisable until 2013,<br>to purchase<br>common stock at \$.001 per share<br>(B)  | 10 shs.  | 08/04/05            | 72,617     | 445,611    |
| Crane Rental Corporation<br>A crane rental company since 1960, headquartered in Florida.   |  |                     |            |            |

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|   |              |          |                      |                |
|---|--------------|----------|----------------------|----------------|
| 13% Senior Subordinated Note<br>due 2015  | \$ 1,215,000 | 08/21/08 | 1,150,784            | 1,208,079      |
| Common Stock (B)  | 135,000 shs. | 08/21/08 | 135,000              | -              |
| Warrant, exercisable until 2016,<br>to purchase<br>common stock at \$.01 per share<br>(B) | 72,037 shs.  | 08/21/08 | 103,143<br>1,388,927 | -<br>1,208,079 |

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## 2012 Annual Report

## CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)

December 31, 2012

| Corporate Restricted Securities: (A) (Continued)   | Principal<br>Amount,<br>Shares,<br>Units or<br>Ownership<br>Percentage | Acquisition<br>Date | Cost      | Fair Value  |
|--|--|---------------------|-----------|-------------|
| <b>Custom Engineered Wheels, Inc.</b>  |  |                     |           |             |
| A manufacturer of custom engineered, non-pneumatic plastic wheels and plastic tread cap tires used primarily for lawn and garden products and wheelchairs. |  |                     |           |             |
| 12.5% Senior Subordinated Note due 2016  | \$1,025,480  | 10/27/09            | \$933,895 | \$1,025,480 |
| Preferred Stock PIK (B)  | 156 shs.   | 10/27/09            | 156,468   | 169,744     |
| Preferred Stock Series A (B)   | 114 shs.   | 10/27/09            | 104,374   | 124,018     |
| Common Stock (B)   | 38 shs.  | 10/27/09            | 38,244    | -           |
| Warrant, exercisable until 2016, to purchase common stock at \$.01 per share (B)   | 28 shs.  | 10/27/09            | 25,735    | -           |
|  |  |                     | 1,258,716 | 1,319,242   |
| <b>DPL Holding Corporation</b>   |  |                     |           |             |
| A distributor and manufacturer of aftermarket undercarriage parts for medium and heavy duty trucks and trailers.   |  |                     |           |             |
| 14% Senior Subordinated Note due 2019  | \$1,296,277  | 05/04/12            | 1,272,096 | 1,348,128   |
| Preferred Stock (B)  | 25 shs.  | 05/04/12            | 252,434   | 260,823     |
| Common Stock (B)   | 25 shs.  | 05/04/12            | 28,048    | 28,042      |
|  |  |                     | 1,552,578 | 1,636,993   |
| <b>Duncan Systems, Inc.</b>  |  |                     |           |             |
| A distributor of windshields and side glass for the recreational vehicle market.   |  |                     |           |             |
| 10% Senior Secured Term Note due 2013  | \$77,143   | 11/01/06            | 76,960    | 76,597      |
| 13% Senior Subordinated Note due 2014  | \$488,572  | 11/01/06            | 469,821   | 483,304     |
| Common Stock (B)   | 102,857 shs.   | 11/01/06            | 102,857   | 19,877      |
| Warrant, exercisable until 2014, to purchase common stock at \$.01 per share (B)   | 32,294 shs.  | 11/01/06            | 44,663    | 6,241       |
|  |  |                     | 694,301   | 586,019     |
| <b>E S P Holdco, Inc.</b>  |  |                     |           |             |
| A manufacturer of power protection technology for commercial office equipment, primarily supplying the office equipment dealer network.                    |  |                     |           |             |
| 14% Senior Subordinated Note due 2015  | \$1,298,152  | 01/08/08            | 1,285,807 | 1,298,152   |
| Common Stock (B)   | 349 shs.   | 01/08/08            | 174,701   | 195,609     |
|  |  |                     | 1,460,508 | 1,493,761   |
| <b>E X C Acquisition Corporation</b>   |  |                     |           |             |
| A manufacturer of pre-filled syringes and pump systems used for intravenous drug delivery.   |  |                     |           |             |
| Warrant, exercisable until 2014, to purchase common stock at \$.01 per share (B)   | 11 shs.  | 06/28/04            | 40,875    | 18,452      |





## Babson Capital Participation Investors

## CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)

December 31, 2012

| Corporate Restricted Securities: (A) (Continued)  | Principal Amount, Shares, Units or Ownership Percentage | Acquisition Date | Cost      | Fair Value |
|---|---|------------------|-----------|------------|
| <b>Eatem Holding Company</b>  |   |                  |           |            |
| A developer and manufacturer of savory flavor systems for soups, sauces, gravies, and other products produced by food manufacturers for retail and foodservice end products.  |   |                  |           |            |
| 12.5% Senior Subordinated Note due 2018   | \$950,000   | 02/01/10         | \$853,634 | \$961,392  |
| Common Stock (B)  | 50 shs.   | 02/01/10         | 50,000    | 45,489     |
| Warrant, exercisable until 2018, to purchase common stock at \$.01 per share (B)  | 119 shs.  | 02/01/10         | 107,100   | 108,464    |
|   |   |                  | 1,010,734 | 1,115,345  |
| <b>ELT Holding Company</b>  |   |                  |           |            |
| A provider of web-based ethics and compliance training solutions for companies in the United States.  |   |                  |           |            |
| 14% Senior Subordinated Note due 2019   | \$924,581   | 03/01/12         | 907,836   | 952,319    |
| Common Stock (B)  | 41 shs.   | 03/01/12         | 90,909    | 101,445    |
|   |   |                  | 998,745   | 1,053,764  |
| <b>F F C Holding Corporation</b>  |   |                  |           |            |
| A leading U.S. manufacturer of private label frozen novelty and ice cream products.   |   |                  |           |            |
| 16% Senior Subordinated Note due 2017   | \$897,252   | 09/27/10         | 885,097   | 906,224    |
| Limited Liability Company Unit Preferred (B)  | 171 uts.  | 09/27/10         | 58,345    | 180,586    |
| Limited Liability Company Unit (B)  | 171 uts.  | 09/27/10         | 17,073    | 95,451     |
|   |   |                  | 960,515   | 1,182,261  |
| <b>F G I Equity LLC</b>   |   |                  |           |            |
| A manufacturer of a broad range of filters and related products that are used in commercial, light industrial, healthcare, gas turbine, nuclear, laboratory, clean room, hotel, educational system, and food processing settings. |   |                  |           |            |
| 14.25% Senior Subordinated Note due 2018  | \$112,118   | 02/29/12         | 112,152   | 115,482    |
| Limited Liability Company Unit Class B-1 (B)  | 65,789 uts.   | 12/15/10         | 65,789    | 137,903    |
| Limited Liability Company Unit Class B-2 (B)  | 8,248 uts.  | 12/15/10         | 8,248     | 17,289     |
| Limited Liability Company Unit Class B-3 (B)  | 6,522 uts.  | 08/30/12         | 15,000    | 15,281     |
| Limited Liability Company Unit Class C (B)  | 1,575 uts.  | 12/20/10         | 16,009    | 27,410     |
|   |   |                  | 217,198   | 313,365    |
| <b>Flutes, Inc.</b>   |   |                  |           |            |
| An independent manufacturer of micro fluted corrugated sheet material for the food and consumer products packaging industries.  |   |                  |           |            |
| 10% Senior Secured Term Note due 2014 (D)   | \$524,791   | 04/13/06         | 519,050   | 498,551    |
| 14% Senior Subordinated Note due 2015 (D)   | \$317,177   | 04/13/06         | 290,908   | -          |
|   |   |                  | 809,958   | 498,551    |
| <b>G C Holdings</b>   |   |                  |           |            |
| A leading manufacturer of gaming tickets, industrial recording charts, security-enabled point-of sale receipts, and medical charts and supplies.  |   |                  |           |            |
| 12.5% Senior Subordinated Note due 2017   | \$1,000,000   | 10/19/10         | 948,079   | 1,010,000  |

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|   |          |          |                   |                      |
|---|----------|----------|-------------------|----------------------|
| Warrant, exercisable until 2018, to purchase<br>common stock at \$.01 per share (B) | 198 shs. | 10/19/10 | 46,958<br>995,037 | 425,172<br>1,435,172 |
|---|----------|----------|-------------------|----------------------|

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## 2012 Annual Report

## CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)

December 31, 2012

| Corporate Restricted Securities: (A)<br>(Continued)   | Principal<br>Amount,<br>Shares,<br>Units or<br>Ownership<br>Percentage | Acquisition<br>Date | Cost         | Fair Value   |
|---|--|---------------------|--------------|--------------|
| <b>GD Dental Services LLC</b>   |  |                     |              |              |
| A provider of convenient "onestop" general, specialty, and cosmetic dental services with 21 offices located throughout South and Central Florida. |  |                     |              |              |
| 14% Senior Subordinated Note due 2019   | \$ 1,178,854   | 10/05/12            | \$ 1,155,868 | \$ 1,181,919 |
| Limited Liability Company Unit Common (B)   | 767 uts.   | 10/05/12            | 767          | 729          |
| Limited Liability Company Unit Preferred (B)  | 76 uts.  | 10/05/12            | 75,920       | 72,124       |
|   |  |                     | 1,232,555    | 1,254,772    |
| <b>Golden County Foods Holding, Inc.</b>  |  |                     |              |              |
| A manufacturer of frozen appetizers and snacks.   |  |                     |              |              |
| 16% Senior Subordinated Note due 2015 (D)   | \$ 1,012,500   | 11/01/07            | 938,215      | -            |
| 14% PIK Note due 2015 (D)   | \$ 250,259   | 12/31/08            | 217,699      | -            |
| 8% Series A Convertible Preferred Stock, convertible into common shares (B)   | 151,643 shs.   | 11/01/07            | 77,643       | -            |
|   |  |                     | 1,233,557    | -            |
| <b>H M Holding Company</b>  |  |                     |              |              |
| A designer, manufacturer, and importer of promotional and wood furniture.   |  |                     |              |              |
| 7.5% Senior Subordinated Note due 2014 (D)  | \$ 362,700   | 10/15/09            | 271,181      | 36,270       |
| Preferred Stock (B)   | 21 shs.  | *                   | 21,428       | -            |
| Preferred Stock Series B (B)  | 1,088 shs.   | 10/15/09            | 813,544      | -            |
| Common Stock (B)  | 180 shs.   | 02/10/06            | 180,000      | -            |
| Common Stock Class C (B)  | 296 shs.   | 10/15/09            | -            | -            |
| Warrant, exercisable until 2013, to purchase common stock at \$.02 per share (B)  | 67 shs.  | 02/10/06            | 61,875       | -            |
| * 09/18/07 and 06/27/08.  |  |                     | 1,348,028    | 36,270       |
| <b>Handi Quilter Holding Company</b>  |  |                     |              |              |

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A designer and manufacturer of long-arm quilting machines and related components for the consumer quilting market.

|  |            |          |         |         |
|--|------------|----------|---------|---------|
| 12% Senior Subordinated Note due 2017  | \$ 461,539 | 11/14/11 | 431,309 | 475,385 |
| Common Stock (B)   | 38 shs.    | 11/14/11 | 38,461  | 48,633  |
| Warrant, exercisable until 2021, to purchase common stock at \$.01 per share (B) | 28 shs.    | 11/14/11 | 25,596  | 34,824  |
|  |            |          | 495,366 | 558,842 |

Healthcare Direct Holding Company

A direct-to-customer marketer of discount dental plans.

|                                       |            |          |         |         |
|---------------------------------------|------------|----------|---------|---------|
| 14% Senior Subordinated Note due 2019 | \$ 709,904 | 03/09/12 | 697,022 | 668,802 |
| Common Stock (B)                      | 517 shs.   | 03/09/12 | 51,724  | 33,319  |
|                                       |            |          | 748,746 | 702,121 |

## Babson Capital Participation Investors

## CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)

December 31, 2012

| Corporate Restricted Securities: (A) (Continued)   | Principal Amount, Shares, Units or Ownership Percentage | Acquisition Date | Cost      | Fair Value |
|--|---|------------------|-----------|------------|
| <b>HGGC Citadel Plastics Holdings</b>  |   |                  |           |            |
| A world-leading source for thermoset and thermoplastic compounds.  |   |                  |           |            |
| 14% Senior Subordinated Note due 2019  | \$ 914,566  | 02/29/12         | \$898,002 | \$932,341  |
| Common Stock (B)   | 101 shs.  | 02/29/12         | 100,806   | 106,237    |
|  |   |                  | 998,808   | 1,038,578  |
| <b>Home Décor Holding Company</b>  |   |                  |           |            |
| A designer, manufacturer and marketer of framed art and wall décor products.                               |   |                  |           |            |
| Common Stock (B)   |   | 33 shs. *        | 33,216    | 76,228     |
| Warrant, exercisable until 2013, to purchase common stock at \$.02 per share (B)                           |   | 106 shs. *       | 105,618   | 242,359    |
| * 06/30/04 and 08/19/04.   |   |                  | 138,834   | 318,587    |
| <b>HOP Entertainment LLC</b>   |   |                  |           |            |
| A provider of post production equipment and services to producers of television shows and motion pictures. |   |                  |           |            |
| Limited Liability Company  |   |                  |           |            |
| Unit Class F (B)   | 47 uts.   | 10/14/11         | -         | -          |
| Limited Liability Company  |   |                  |           |            |
| Unit Class G (B)   | 114 uts.  | 10/14/11         | -         | -          |
| Limited Liability Company  |   |                  |           |            |
| Unit Class H (B)   | 47 uts.   | 10/14/11         | -         | -          |
| Limited Liability Company  |   |                  |           |            |
| Unit Class I (B)   | 47 uts.   | 10/14/11         | -         | -          |
| <b>Hospitality Mints Holding Company</b>   |   |                  |           |            |
| A manufacturer of individually-wrapped imprinted promotional mints.  |   |                  |           |            |
| 12% Senior Subordinated Note due 2016  | \$ 1,098,837  | 08/19/08         | 1,050,003 | 1,048,698  |
| 14% Senior Subordinated Note PIK due 2016  | \$ 503,756  | 12/31/09         | 488,918   | 480,770    |
| Common Stock (B)   | 251 shs.  | 08/19/08         | 251,163   | 26,141     |
| Warrant, exercisable until 2016, to purchase common stock at \$.01 per share (B)                           | 65 shs.   | 08/19/08         | 60,233    | 6,757      |
|  |   |                  | 1,850,317 | 1,562,366  |

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HVAC Holdings, Inc.

A provider of integrated energy efficiency services and maintenance programs for HVAC systems.

14% Senior Subordinated

|                              |              |          |           |           |
|------------------------------|--------------|----------|-----------|-----------|
| Note due 2019                | \$ 1,142,298 | 09/27/12 | 1,120,080 | 1,144,768 |
| Preferred Stock Series A (B) | 1,127 shs.   | 09/27/12 | 112,726   | 111,163   |
| Common Stock (B)             | 910 shs.     | 09/27/12 | 910       | -         |
|                              |              |          | 1,233,716 | 1,255,931 |

Ideal Tridon Holdings, Inc.

A designer and manufacturer of clamps and couplings used in automotive and industrial end markets.

13.5% Senior Subordinated

|                  |            |          |           |           |
|------------------|------------|----------|-----------|-----------|
| Note due 2018    | \$ 923,554 | 10/27/11 | 907,535   | 942,025   |
| Common Stock (B) | 93 shs.    | 10/27/11 | 92,854    | 122,882   |
|                  |            |          | 1,000,389 | 1,064,907 |

## 2012 Annual Report

## CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)

December 31, 2012

| Corporate Restricted Securities: (A) (Continued)   |              | Principal<br>Amount,<br>Shares,<br>Units or<br>Ownership<br>Percentage | Acquisition<br>Date | Cost      | Fair Value |
|--|--------------|--|---------------------|-----------|------------|
| <b>Insurance Claims Management, Inc.</b>   |              |  |                     |           |            |
| A third party administrator providing auto and property claim administration services for insurance companies.   |              |  |                     |           |            |
| Common Stock (B)   | 47 shs.      |  | 02/27/07            | \$ 1,424  | \$ 167,951 |
| <b>International Offshore Services LLC</b>   |              |  |                     |           |            |
| A leading provider of marine transportation services, platform decommissioning, and salvage services to oil and gas producers in the shallow waters of the Gulf of Mexico. |              |  |                     |           |            |
| 14.25% Senior Subordinated   |              |  |                     |           |            |
| Secured Note due 2017 (D)  | \$ 1,350,000 |  | 07/07/09            | 1,236,405 | 270,000    |
| Limited Liability Company  |              |  |                     |           |            |
| Unit (B)   | 1,647 uts.   |  | 07/07/09            | 98,833    | -          |
|  |              |  |                     | 1,335,238 | 270,000    |
| <b>J A C Holding Enterprises, Inc.</b>   |              |  |                     |           |            |
| A supplier of luggage racks and accessories to the original equipment manufacturers.   |              |  |                     |           |            |
| 12.5% Senior Subordinated  |              |  |                     |           |            |
| Note due 2017  | \$ 833,333   |  | 12/20/10            | 734,311   | 810,540    |
| Preferred Stock A (B)  | 165 shs.     |  | 12/20/10            | 165,000   | 101,678    |
| Preferred Stock B (B)  | 0.06 shs.    |  | 12/20/10            | -         | 37         |
| Common Stock (B)   | 33 shs.      |  | 12/20/10            | 1,667     | -          |
| Warrant, exercisable until 2020, to purchase common stock at \$.01 per share (B)   |              |  |                     |           |            |
|  | 12 shs.      |  | 12/20/10            | 105,643   | -          |
|  |              |  |                     | 1,006,621 | 912,255    |
| <b>Jason Partners Holdings LLC</b>   |              |  |                     |           |            |
| A diversified manufacturing company serving various industrial markets.  |              |  |                     |           |            |
| Limited Liability Company  |              |  |                     |           |            |
| Unit (B)   | 48 uts.      |  | 09/21/10            | 449,086   | 25,511     |
| <b>JMH Investors LLC</b>   |              |  |                     |           |            |
| A developer and manufacturer of custom formulations for a wide variety of foods.   |              |  |                     |           |            |
| 14.25% Senior Subordinated   |              |  |                     |           |            |
| Note due 2019  | \$ 1,034,222 |  | 12/05/12            | 1,013,699 | 1,031,073  |
| Limited Liability Company  |              |  |                     |           |            |
| Unit (B)   | 217,391 uts. |  | 12/05/12            | 217,391   | 206,521    |



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|   |            |          |           |           |
|---|------------|----------|-----------|-----------|
|   |            |          | 1,231,090 | 1,237,594 |
| K & N Parent, Inc.  |            |          |           |           |
| A manufacturer and supplier of automotive aftermarket performance air filters and intake systems. |            |          |           |           |
| 14% Senior Subordinated   |            |          |           |           |
| Note due 2017   | \$ 878,282 | 12/23/11 | 862,714   | 904,631   |
| Preferred Stock Series A (B)  | 102 shs.   | 12/23/11 | 96,578    | 96,577    |
| Preferred Stock Series B (B)  | 29 shs.    | 12/23/11 | 27,335    | 27,332    |
| Common Stock (B)  | 130 shs.   | 12/23/11 | 6,522     | 53,118    |
|   |            |          | 993,149   | 1,081,658 |

## Babson Capital Participation Investors

## CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)

December 31, 2012

| Corporate Restricted Securities: (A)<br>(Continued)  | Principal<br>Amount,<br>Shares,<br>Units or<br>Ownership<br>Percentage | Acquisition<br>Date | Cost         | Fair Value   |
|--|--|---------------------|--------------|--------------|
| <b>K N B Holdings Corporation</b>  |  |                     |              |              |
| A designer, manufacturer and marketer of products for the custom framing market.   |  |                     |              |              |
| 15% Senior Subordinated Note due 2017  | \$2,235,132  | *                   | \$ 2,073,093 | \$ 2,235,132 |
|  | 71,053   |                     |              |              |
| Common Stock (B)   | shs.   | 05/25/06            | 71,053       | 35,018       |
| Warrant, exercisable until 2013, to purchase   |  |                     |              |              |
|  | 43,600   |                     |              |              |
| common stock at \$.01 per share (B)  | shs.   | 05/25/06            | 37,871       | 21,488       |
| * 5/25/06 and 04/12/11.  |  |                     | 2,182,017    | 2,291,638    |
| <b>K P H I Holdings, Inc.</b>  |  |                     |              |              |
| A manufacturer of highly engineered plastic and metal components for a diverse range of end-markets, including medical, consumer and industrial, automotive and defense. |  |                     |              |              |
| 15% Senior Subordinated Note due 2017  | \$ 915,268   | 12/10/10            | 901,293      | 933,573      |
| Common Stock (B)   | 232,826 shs.   | 12/10/10            | 232,826      | 216,519      |
|  |  |                     | 1,134,119    | 1,150,092    |
| <b>K P I Holdings, Inc.</b>  |  |                     |              |              |
| The largest player in the U.S. non-automotive, non-ferrous die casting segment.  |  |                     |              |              |
| 12.75% Senior Subordinated Note due 2015   | \$ 1,440,282   | 07/16/08            | 1,375,363    | 1,440,282    |
| Convertible Preferred Stock Series C (B)   | 29 shs.  | 06/30/09            | 29,348       | 58,000       |
| Convertible Preferred Stock Series D (B)   | 13 shs.  | 09/17/09            | 12,958       | 38,880       |
| Common Stock (B)   | 235 shs.   | 07/15/08            | 234,783      | 15,625       |
| Warrant, exercisable until 2018, to purchase   |  |                     |              |              |
| common stock at \$.01 per share (B)  | 51 shs.  | 07/16/08            | 50,836       | 3,384        |
| Warrant, exercisable until 2018, to purchase   |  |                     |              |              |
| common stock at \$.01 per share (B)  | 67 shs.  | 09/17/09            | -            | 4,486        |
|  |  |                     | 1,703,288    | 1,560,657    |
| <b>LPC Holding Company</b>   |  |                     |              |              |
| A designer and manufacturer of precision-molded silicone rubber components that are utilized in the medical and automotive end markets.                                  |  |                     |              |              |
| 13.5% Senior Subordinated Note due 2018  | \$ 1,162,145   | 08/15/11            | 1,142,137    | 1,185,388    |

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|   |          |          |           |           |
|---|----------|----------|-----------|-----------|
| Common Stock (B)  | 105 shs. | 08/15/11 | 105,019   | 112,225   |
|   |          |          | 1,247,156 | 1,297,613 |
| M V I Holding, Inc.   |          |          |           |           |
| A manufacturer of large precision machined metal components used in equipment which services a variety of industries, including the oil and gas, mining, and defense markets. |          |          |           |           |
| Common Stock (B)  | 32 shs.  | 09/12/08 | 32,143    | 67,548    |
| Warrant, exercisable until 2018, to purchase common stock at \$.01 per share (B)  | 35 shs.  | 09/12/08 | 34,714    | 72,950    |
|   |          |          | 66,857    | 140,498   |

## 2012 Annual Report

## CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)

December 31, 2012

| Corporate Restricted Securities: (A)<br>(Continued)   | Principal<br>Amount,<br>Shares,<br>Units or<br>Ownership<br>Percentage | Acquisition<br>Date | Cost       | Fair Value |
|---|--|---------------------|------------|------------|
| <b>Mail Communications Group, Inc.</b>  |  |                     |            |            |
| A provider of mail processing and handling services, lettershop services, and commercial printing services.   |  |                     |            |            |
|   | 12,764<br>uts.   | *                   | \$ 166,481 | \$ 268,395 |
| Limited Liability Company Unit (B)  |  |                     |            |            |
| Warrant, exercisable until 2014, to purchase<br>common stock at \$.01 per share (B)   | 1,787 shs.   | 05/04/07            | 22,781     | 37,578     |
| * 05/04/07 and 01/02/08.  |  |                     | 189,262    | 305,973    |
| <b>Manhattan Beachwear Holding Company</b>  |  |                     |            |            |
| A designer and distributor of women's swimwear.   |  |                     |            |            |
| 12.5% Senior Subordinated Note due 2018   | \$419,971  | 01/15/10            | 379,420    | 419,971    |
| 15% Senior Subordinated Note due 2018   | \$108,291  | 10/05/10            | 106,604    | 107,201    |
| Common Stock (B)  | 35 shs.  | 10/05/10            | 35,400     | 49,872     |
| Common Stock Class B (B)  | 118 shs.   | 01/15/10            | 117,647    | 165,747    |
| Warrant, exercisable until 2019, to purchase<br>common stock at \$.01 per share (B)   | 104 shs.   | 01/15/10            | 94,579     | 146,685    |
|   |  |                     | 733,650    | 889,476    |
| <b>Marshall Physicians Services LLC</b>   |  |                     |            |            |
| A provider of emergency department and hospital medicine services to hospitals located in the state of Kentucky. The company was founded in 1999 and is owned by seven practicing physicians. |  |                     |            |            |
| 13% Senior Subordinated Note due 2016   | \$ 445,651   | 09/20/11            | 437,985    | 458,334    |
| Limited Liability Company Unit Class A (B)  | 2,900 uts.   | 09/20/11            | 60,000     | 39,424     |
| Limited Liability Company Unit Class D (B)  | 291 uts.   | 09/20/11            | -          | 3,962      |
|   |  |                     | 497,985    | 501,720    |
| <b>MBWS Ultimate Holdco, Inc.</b>   |  |                     |            |            |
| A provider of services throughout North Dakota that address the fluid management and related transportation needs of an oil well.   |  |                     |            |            |
| 12% Senior Subordinated Note due 2016   | \$1,117,495  | *                   | 1,039,475  | 1,128,670  |
| Preferred Stock Series A (B)  | 1,388 shs.   | 09/07/10            | 138,797    | 443,369    |
| Common Stock (B)  | 162 shs.   | 03/01/11            | 16,226     | 51,748     |
| Common Stock (B)  | 153 shs.   | 09/07/10            | 15,282     | 48,873     |
| Warrant, exercisable until 2020, to purchase<br>common stock at \$.01 per share (B)   | 103 shs.   | 03/01/11            | 10,325     | 32,901     |
| Warrant, exercisable until 2016, to purchase<br>common stock at \$.01 per share (B)   | 386 shs.   | 09/07/10            | 38,623     | 123,300    |
| * 09/07/10 and 03/01/11.  |  |                     | 1,258,728  | 1,828,861  |



## Babson Capital Participation Investors

## CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)

December 31, 2012

| Corporate Restricted Securities: (A)<br>(Continued)   | Principal<br>Amount,<br>Shares,<br>Units or<br>Ownership<br>Percentage | Acquisition<br>Date | Cost       | Fair Value |
|---|--|---------------------|------------|------------|
| <b>MedSystems Holdings LLC</b>  |  |                     |            |            |
| A manufacturer of enteral feeding products, such as feeding tubes and other products related to assisted feeding. |  |                     |            |            |
| 13% Senior Subordinated Note due  |  |                     |            |            |
| 2015  | \$634,782  | 08/29/08            | \$ 594,388 | \$ 634,782 |
| Preferred Unit (B)  | 66 uts.  | 08/29/08            | 66,451     | 91,881     |
| Common Unit Class A (B)   | 671 uts.   | 08/29/08            | 671        | 11,641     |
| Common Unit Class B (B)   | 250 uts.   | 08/29/08            | 63,564     | 4,331      |
|   |  |                     | 725,074    | 742,635    |

**MEGTEC Holdings, Inc.**

A supplier of industrial and environmental products and services to a broad array of industries.

|  |            |          |         |         |
|--|------------|----------|---------|---------|
| Preferred Stock (B)                          | 56 shs.    | 09/24/08 | 54,040  | 80,376  |
| Limited Partnership Interest (B)             | 0.74% int. | 09/16/08 | 205,932 | 263,045 |
| Warrant, exercisable until 2018, to purchase |            |          |         |         |
| common stock at \$.01 per share (B)          | 18 shs.    | 09/24/08 | 18,237  | 18,338  |
|  |            |          | 278,209 | 361,759 |

**Merex Holding Corporation**

A provider of after-market spare parts and components, as well as Maintenance, Repair and Overhaul services for "out of production" or "legacy" aerospace and defense systems that are no longer effectively supported by the original equipment manufacturers.

|                                  |              |          |         |         |
|----------------------------------|--------------|----------|---------|---------|
| 14% Senior Subordinated Note due |              |          |         |         |
| 2018                             | \$ 424,528   | 09/22/11 | 417,060 | 437,264 |
| Limited Liability Company Unit   |              |          |         |         |
| Series B (B)                     | 155,945 uts. | 09/22/11 | 155,945 | 173,893 |
|                                  |              |          | 573,005 | 611,157 |

**MicroGroup, Inc.**

A manufacturer of precision parts and assemblies, and a value-added supplier of metal tubing and bars.

|  |            |          |           |         |
|--|------------|----------|-----------|---------|
| 7% Senior Subordinated Note due              |            |          |           |         |
| 2014 (D)                                     | \$ 902,727 | *        | 865,676   | 225,682 |
| Preferred Stock Series A (B)                 | 519 shs.   | 10/10/12 | 498,734   | -       |
| Common Stock (B)                             | 238 shs.   | *        | 238,000   | -       |
| Common Stock Series B (B)                    | 597 shs.   | 10/10/12 | 6         | -       |
| Warrant, exercisable until 2014, to purchase |            |          |           |         |
| common stock at \$.02 per share (B)          | 87 shs.    | *        | 86,281    | -       |
|  |            |          | 1,688,697 | 225,682 |

\*08/12/05 and 09/11/06.

**MNX Holding Company**

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An international third party logistics company providing customized logistics services to customers across the globe.

14% Senior Subordinated Note due

|                  |              |          |           |           |
|------------------|--------------|----------|-----------|-----------|
| 2019             | \$ 1,209,241 | 11/02/12 | 1,185,470 | 1,202,942 |
| Common Stock (B) | 45 shs.      | 11/02/12 | 44,643    | 42,408    |
|                  |              |          | 1,230,113 | 1,245,350 |

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## 2012 Annual Report

## CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)

December 31, 2012

| Corporate Restricted Securities: (A) (Continued)   |              | Principal<br>Amount,<br>Shares,<br>Units or<br>Ownership<br>Percentage | Acquisition<br>Date | Cost   | Fair Value         |
|--|--------------|--|---------------------|--------|--------------------|
| <b>Monessen Holding Corporation</b>  |              |  |                     |        |                    |
| A designer and manufacturer of a broad line of gas, wood, and electric hearth products and accessories.                              |              |  |                     |        |                    |
| 15% Senior Subordinated Note due<br>2015 (D)   | \$ 823,794   | 06/28/11   | \$ 547,745          | \$ -   |                    |
| 7% Senior Subordinated Note due<br>2014 (D)  | \$ 1,350,000 | 06/28/11   | 1,281,479           | -      |                    |
| Warrant, exercisable until 2014, to<br>purchase<br>common stock at \$.02 per share (B)   | 81 shs.      | 03/31/06   | 73,125<br>1,902,349 | -<br>- |                    |
| <b>Motion Controls Holdings</b>  |              |  |                     |        |                    |
| A manufacturer of high performance mechanical motion control and linkage products.   |              |  |                     |        |                    |
| 14.25% Senior Subordinated Note<br>due 2017  | \$ 940,419   | 11/30/10   | 926,772             |        | 949,823            |
| Limited Liability Company Unit<br>Class B-1 (B)  | 93,750 uts.  | 11/30/10   | -                   |        | 71,218             |
| Limited Liability Company Unit<br>Class B-2 (B)  | 8,501 uts.   | 11/30/10   | -<br>926,772        |        | 6,458<br>1,027,499 |
| <b>NABCO, Inc.</b>   |              |  |                     |        |                    |
| A producer of explosive containment vessels in the United States.  |              |  |                     |        |                    |
| Common Stock (B)   | 429 shs.     | 12/20/12   | 306,091             |        | 177,544            |
| <b>NetShape Technologies, Inc.</b>   |              |  |                     |        |                    |
| A manufacturer of powder metal and metal injection molded precision components used in industrial, consumer, and other applications. |              |  |                     |        |                    |
| 14% Senior Subordinated Note due<br>2014   | \$ 1,061,463 | 02/02/07   | 982,553             |        | 1,008,389          |
| Limited Partnership Interest of<br>Saw Mill PCG Partners LLC (B)   | 1.38% int.   | 02/01/07   | 588,077             |        | 79,846             |
| Limited Liability Company Unit<br>Class D of<br>Saw Mill PCG Partners LLC (B)  | 9 uts.       | *  | 8,873               |        | 1,204              |
| Limited Liability Company Unit<br>Class D-1 of<br>Saw Mill PCG Partners LLC (B)  | 121 uts.     | 09/30/09   | 121,160             |        | 16,450             |
| Limited Liability Company Unit<br>Class D-2 of   |              |  |                     |        |                    |



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|                               |         |          |           |           |
|-------------------------------|---------|----------|-----------|-----------|
| Saw Mill PCG Partners LLC (B) | 68 uts. | 04/29/11 | 34,547    | 9,225     |
| * 12/18/08 and 09/30/09.      |         |          | 1,735,210 | 1,115,114 |

Nicoat Acquisitions LLC

A manufacturer of water-based and ultraviolet coatings for high-performance graphic arts, packaging and other specialty coating applications.

|   |             |          |         |         |
|---|-------------|----------|---------|---------|
| 14% Senior Subordinated Note due 2018       | \$ 484,388  | 11/05/10 | 450,954 | 489,232 |
| Limited Liability Company Unit Series B (B) | 17,241 uts. | 11/05/10 | 17,241  | 20,091  |
| Limited Liability Company Unit Series B (B) | 34,931 uts. | 11/05/10 | 34,931  | 40,704  |
| Limited Liability Company Unit Series F (B) | 52,172 uts. | 11/05/10 | -       | 179,458 |
|   |             |          | 503,126 | 729,485 |

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## Babson Capital Participation Investors

## CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)

December 31, 2012

| Corporate Restricted Securities: (A) (Continued)   |              | Principal<br>Amount,<br>Shares,<br>Units or<br>Ownership<br>Percentage | Acquisition<br>Date | Cost         | Fair Value   |
|--|--------------|--|---------------------|--------------|--------------|
| Northwest Mailing Services, Inc.<br>A producer of promotional materials for companies that use direct mail as part of their customer retention and loyalty programs. |              |  |                     |              |              |
| 12% Senior Subordinated Note due 2016  | \$ 1,492,105 | *  |                     | \$ 1,300,290 | \$ 1,500,137 |
| Limited Partnership Interest (B)   | 1,740 uts.   | *  |                     | 174,006      | 55,940       |
| Warrant, exercisable until 2019, to purchase common stock at \$.01 per share (B)   | 2,605 shs.   | *  |                     | 260,479      | 83,739       |
| *07/09/09 and 08/09/10.  |              |  |                     | 1,734,775    | 1,639,816    |
| NT Holding Company<br>A leading developer, manufacturer and provider of medical products used primarily in interventional pain management.                           |              |  |                     |              |              |
| 12% Senior Subordinated Note due 2019  | \$ 883,117   |  | 02/02/11            | 823,518      | 900,779      |
| Common Stock (B)   | 126 shs.     | *  |                     | 125,883      | 100,618      |
| Warrant, exercisable until 2021, to purchase common stock at \$.01 per share (B)   | 59 shs.      |  | 02/02/11            | 52,987       | 46,960       |
| *02/02/11 and 06/30/11.  |              |  |                     | 1,002,388    | 1,048,357    |
| O E C Holding Corporation<br>A provider of elevator maintenance, repair and modernization services.  |              |  |                     |              |              |
| 13% Senior Subordinated Note due 2017  | \$ 444,445   |  | 06/04/10            | 414,553      | 444,445      |
| Preferred Stock Series A (B)   | 554 shs.     |  | 06/04/10            | 55,354       | 24,479       |
| Preferred Stock Series B (B)   | 311 shs.     |  | 06/04/10            | 31,125       | 13,764       |
| Common Stock (B)   | 344 shs.     |  | 06/04/10            | 344          | -            |
|  |              |  |                     | 501,376      | 482,688      |
| Ontario Drive & Gear Ltd.<br>A manufacturer of all-wheel drive, off-road amphibious vehicles and related accessories.  |              |  |                     |              |              |
| Limited Liability Company Unit (B)   | 1,942 uts.   |  | 01/17/06            | 302,885      | 823,030      |

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|   |              |          |                   |                    |
|---|--------------|----------|-------------------|--------------------|
| Warrant, exercisable until<br>2013, to purchase<br>common stock at \$.01 per<br>share (B)           | 328 shs.     | 01/17/06 | 90,424<br>393,309 | 138,958<br>961,988 |
| P K C Holding Corporation   |              |          |                   |                    |
| A manufacturer of plastic film and badges for the general industrial, medical, and food industries. |              |          |                   |                    |
| 14% Senior Subordinated Note<br>due 2016  | \$ 1,616,671 | 12/21/10 | 1,592,787         | 1,632,838          |
| Preferred Stock Class A (B)   | 29 shs.      | 12/21/10 | 180,380           | 282,474            |
| Common Stock (B)  | 29 shs.      | 12/21/10 | 13,500            | -                  |
|   |              |          | 1,786,667         | 1,915,312          |

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## 2012 Annual Report

## CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)

December 31, 2012

| Corporate Restricted Securities: (A)<br>(Continued)   | Principal<br>Amount,<br>Shares,<br>Units or<br>Ownership<br>Percentage | Acquisition<br>Date | Cost       | Fair Value |
|---|--|---------------------|------------|------------|
| <b>P P T Holdings LLC</b>   |  |                     |            |            |
| A high-end packaging solutions provider that targets customers who have multiple packaging needs, require a high number of low volume SKUs, short lead times, technical expertise, and overall supply chain management. |  |                     |            |            |
| 15% Senior Subordinated Note due<br>2017  | \$ 949,503   | 12/20/10            | \$ 935,159 | \$ 951,155 |
| Limited Liability Company Unit Class<br>A (B)   | 33 uts.  | 12/20/10            | 106,071    | 77,858     |
| Limited Liability Company Unit Class B<br>(B)   | 33 uts.  | 12/20/10            | 1,072      | 77,858     |
|   |  |                     | 1,042,302  | 1,106,871  |
| <b>Pacific Consolidated Holdings LLC</b>  |  |                     |            |            |
| A manufacturer of rugged, mobile liquid and gaseous oxygen and nitrogen generating systems used in the global defense, oil and gas, and medical sectors.  |  |                     |            |            |
| 0% Senior Subordinated Note due 2014  | \$ 42,187  | 12/18/12            | -          | 42,187     |
| <b>Paradigm Packaging, Inc.</b>   |  |                     |            |            |
| A manufacturer of plastic bottles and closures for the nutritional, pharmaceutical, personal care, and food packaging markets.  |  |                     |            |            |
| 12% Senior Subordinated Note due<br>2015  | \$ 843,750   | 12/19/00            | 842,146    | 843,750    |
| Warrant, exercisable until 2015, to<br>purchase<br>common stock at \$.01 per share (B)  | 197 shs.   | 12/21/00            | 140,625    | 31,655     |
|   |  |                     | 982,771    | 875,405    |
| <b>Pearlman Enterprises, Inc.</b>   |  |                     |            |            |
| A developer and distributor of tools, equipment and supplies to the natural and engineered stone industry.  |  |                     |            |            |
| Preferred Stock Series A (B)  | 1,236 shs.   | 05/22/09            | 59,034     | -          |
| Preferred Stock Series B (B)  | 7,059 shs.   | 05/22/09            | 290,050    | -          |
| Common Stock (B)  | 21,462 shs.  | 05/22/09            | 993,816    | -          |
|   |  |                     | 1,342,900  | -          |
| <b>Petroplex Inv Holdings LLC</b>   |  |                     |            |            |
| A leading provider of acidizing services to E&P customers in the Permian Basin.   |  |                     |            |            |
| 16% Senior Subordinated Note due<br>2018  | \$ 1,097,760   | 11/29/12            | 1,070,700  | 1,094,626  |
| Limited Liability Company Unit<br>(B)   | 156,250 uts.   | 11/29/12            | 156,250    | 148,437    |
|   |  |                     | 1,226,950  | 1,243,063  |
| <b>Postle Aluminum Company LLC</b>  |  |                     |            |            |

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A manufacturer and distributor of aluminum extruded products.

|  |              |          |           |           |
|--|--------------|----------|-----------|-----------|
| 15% Senior Subordinated Note due 2013  | \$ 874,879   | 06/03/10 | 870,007   | 874,878   |
| 3% Senior Subordinated PIK Note due 2014   | \$ 1,209,017 | 10/02/06 | 1,112,196 | 1,209,017 |
| Limited Liability Company Unit Class A (B)                                       | 733 uts.     | 10/02/06 | 270,000   | 76,260    |
| Limited Liability Company Unit (B)   | 76 uts.      | 05/22/09 | 340       | 7,910     |
| Warrant, exercisable until 2016, to purchase common stock at \$.01 per share (B) | 4,550 shs.   | 10/02/06 | 65,988    | 473,577   |
|  |              |          | 2,318,531 | 2,641,642 |

## Babson Capital Participation Investors

## CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)

December 31, 2012

| Corporate Restricted Securities: (A) (Continued)   |              | Principal<br>Amount,<br>Shares,<br>Units or<br>Ownership<br>Percentage | Acquisition<br>Date | Cost                 | Fair Value           |
|--|--------------|--|---------------------|----------------------|----------------------|
| Precision Wire Holding Company<br>A manufacturer of specialty medical wires that are used in non-elective minimally invasive surgical procedures.                          |              |  |                     |                      |                      |
| 14.25% Senior Subordinated Note<br>due 2016  | \$1,414,960  |  | 11/12/09            | \$ 1,320,644         | \$ 1,429,110         |
| Warrant, exercisable until 2019, to<br>purchase<br>common stock at \$.01 per share<br>(B)  | 109 shs.     |  | 11/12/09            | 107,970<br>1,428,614 | 129,967<br>1,559,077 |
| Qualis Automotive LLC<br>A distributor of aftermarket automotive brake and chassis products.   |              |  |                     |                      |                      |
| Common Stock (B)   | 187,500 shs. |  | 05/28/04            | 187,500              | 137,946              |
| Warrant, exercisable until 2014, to<br>purchase<br>common stock at \$.01 per share<br>(B)  | 199,969 shs. |  | 05/28/04            | 199,969<br>387,469   | 147,119<br>285,065   |
| R A J Manufacturing Holdings<br>LLC<br>A designer and manufacturer of women's swimwear sold under a variety of licensed brand names.                                       |              |  |                     |                      |                      |
| 12.5% Senior Subordinated Note<br>due 2014   | \$747,145    |  | 12/15/06            | 726,240              | 716,927              |
| Limited Liability Company Unit<br>(B)  | 1,497 uts.   |  | 12/15/06            | 149,723              | 69,212               |
| Warrant, exercisable until 2014, to<br>purchase<br>common stock at \$.01 per share<br>(B)  | 2 shs.       |  | 12/15/06            | 69,609<br>945,572    | 32,661<br>818,800    |
| REVSpring, Inc.<br>A provider of accounts receivable management and revenue cycle management services to customers in the<br>healthcare, financial and utility industries. |              |  |                     |                      |                      |
| 14% Senior Subordinated Note due 2018  |              | \$ 1,137,807   | *                   | 1,118,370            | 1,168,429            |
| Limited Liability Company Unit Class A (B)   |              | 13,548 uts.  | *                   | 135,477              | 124,158              |
| * 10/21/11 and 08/03/12.   |              |  |                     | 1,253,847            | 1,292,587            |

## RM Holding Company

A specialty distributor of home medical care equipment.

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|   |             |          |         |         |
|---|-------------|----------|---------|---------|
| 13% Senior Subordinated Note due 2018   | \$460,318   | 02/09/12 | 434,893 | 473,460 |
| Common Stock (B)  | 369 shs.    | 02/09/12 | 4       | 54,187  |
| Preferred Stock Series (B)  | 39,679 shs. | 02/09/12 | 39,678  | 42,313  |
| Warrant, exercisable until 2022, to purchase preferred stock A at \$.01 per share (B) | 12,088 shs. | 02/09/12 | 11,980  | 12,727  |
| Warrant, exercisable until 2022, to purchase preferred stock B at \$.01 per share (B) | 7,067 shs.  | 02/09/12 | 7,067   | 7,537   |
| Warrant, exercisable until 2022, to purchase common stock at \$.01 per share (B)      | 185 shs.    | 02/09/12 | -       | 27,171  |
|   |             |          | 493,622 | 617,395 |

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## 2012 Annual Report

## CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)

December 31, 2012

| Corporate Restricted Securities: (A) (Continued)   | Principal Amount, Shares, Units or Ownership Percentage | Acquisition Date | Cost      | Fair Value |
|--|---|------------------|-----------|------------|
| <b>Rose City Holding Company</b>   |   |                  |           |            |
| A designer and printer of folding cartons and packaging for food and beverage manufacturers on the West Coast.   |   |                  |           |            |
| 14.5% Senior Subordinated Note due 2018  | \$ 585,934  | 12/11/12         | \$574,296 | \$585,063  |
| Common Stock (B)   | 43 shs.   | 12/11/12         | 4         | 4          |
| Preferred Stock (B)  | 39,062 shs.   | 12/11/12         | 39,062    | 37,109     |
|  |   |                  | 613,362   | 622,176    |
| <b>Safety Infrastructure Solutions</b>   |   |                  |           |            |
| A provider of trench safety equipment to a diverse customer base across multiple end markets in Texas and the Southwestern United States.  |   |                  |           |            |
| 15% Senior Subordinated Note due 2018  | \$ 656,250  | 03/30/12         | 647,214   | 685,323    |
| Preferred Stock Series (B)   | 2,098 shs.  | 03/30/12         | 83,920    | 87,935     |
| Common Stock (B)   | 983 shs.  | 03/30/12         | 9,830     | 28,551     |
|  |   |                  | 740,964   | 801,809    |
| <b>Sencore Holding Company</b>   |   |                  |           |            |
| A designer, manufacturer, and marketer of decoders, receivers and modulators sold to broadcasters, satellite, cable and telecom operators for encoding/decoding analog and digital transmission video signals. |   |                  |           |            |
| 12.5% Senior Subordinated Note due 2014 (D)  | \$ 1,157,231  | 01/15/09         | 826,004   | -          |
| <b>Smart Source Holdings LLC</b>   |   |                  |           |            |
| A short-term computer rental company.  |   |                  |           |            |
| 12% Senior Subordinated Note due 2015  | \$ 1,176,924  | *                | 1,125,813 | 1,176,924  |
| Limited Liability Company Unit (B)   | 328 uts.  | *                | 337,796   | 304,211    |
| Warrant, exercisable until 2015, to purchase common stock at \$.01 per share (B)   | 83 shs.   | *                | 87,231    | 77,057     |
| * 08/31/07 and 03/06/08.   |   |                  | 1,550,840 | 1,558,192  |
| <b>Snacks Parent Corporation</b>   |   |                  |           |            |
| The world's largest provider of trail mixes and a leading provider of snack nuts, dried fruits, and other healthy snack products.  |   |                  |           |            |
| 13% Senior Subordinated Note due 2017  | \$ 887,366  | 11/12/10         | 846,160   | 884,525    |



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|   |            |          |           |           |
|---|------------|----------|-----------|-----------|
| Preferred Stock A (B)   | 1,132 shs. | 11/12/10 | 107,498   | 129,254   |
| Preferred Stock B (B)   | 525 shs.   | 11/12/10 | 49,884    | 59,979    |
| Common Stock (B)  | 6,579 shs. | 11/12/10 | 6,579     | -         |
| Warrant, exercisable until 2020, to purchase<br>common stock at \$.01 per share (B) | 1,806 shs. | 11/12/10 | 1,806     | -         |
|   |            |          | 1,011,927 | 1,073,758 |

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## Babson Capital Participation Investors

## CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)

December 31, 2012

| Corporate Restricted Securities: (A)<br>(Continued)   | Principal<br>Amount,<br>Shares,<br>Units or<br>Ownership<br>Percentage | Acquisition<br>Date | Cost       | Fair Value |
|---|--|---------------------|------------|------------|
| SouthernCare Holdings, Inc.<br>A hospice company providing palliative care services to terminally ill patients.   |  |                     |            |            |
| 14% Senior Subordinated Note due 2018   | \$ 928,955   | 12/01/11            | \$ 912,741 | \$956,461  |
| Common Stock (B)  | 909 shs.   | 12/01/11            | 90,909     | 93,647     |
|   |  |                     | 1,003,650  | 1,050,108  |
| Spartan Foods Holding Company<br>A manufacturer of branded pizza crusts and pancakes.   |  |                     |            |            |
| 14.25% Senior Subordinated PIK Note due 2017  | \$ 1,200,671   | 12/15/09            | 1,070,657  | 1,145,420  |
| Warrant, exercisable until 2018, to purchase common stock at \$.01 per share (B)  | 136 shs.   | 12/15/09            | 120,234    | 40,507     |
|   |  |                     | 1,190,891  | 1,185,927  |
| Specialty Commodities, Inc.<br>A distributor of specialty food ingredients.   |  |                     |            |            |
| Common Stock (B)  | 15,882 shs.  | 10/23/08            | 158,824    | 82,748     |
| Warrant, exercisable until 2018, to purchase common stock at \$.01 per share (B)  | 5,852 shs.   | 10/23/08            | 53,285     | 30,490     |
|   |  |                     | 212,109    | 113,238    |
| Stag Parkway Holding Co.<br>A distributor of RV parts and accessories in the United States.   |  |                     |            |            |
| 13% Senior Subordinated Note due 2018   | \$ 1,131,797   | 12/19/12            | 1,077,551  | 1,134,430  |
| Common Stock (B)  | 118 shs.   | 12/19/12            | 118,203    | 112,290    |
| Warrant, exercisable until 2020, to purchase common stock at \$.01 per share (B)  | 35 shs.  | 12/19/12            | 31,848     | -          |
|   |  |                     | 1,227,602  | 1,246,720  |
| Strata/WLA Holding Corporation<br>A leading independent anatomic pathology laboratory that conducts over 320,000 tests annually to customers in 40 U.S. states and in Canada and Venezuela. |  |                     |            |            |
| 14.5% Senior Subordinated Note due 2018   | \$ 959,148   | 07/01/11            | 943,251    | 960,587    |
| Preferred Stock Series A (B)  | 76 shs.  | 07/01/11            | 76,046     | 33,195     |
|   |  |                     | 1,019,297  | 993,782    |
| Sundance Investco LLC   |  |                     |            |            |

A provider of post-production services to producers of movies and television shows.

Limited Liability Company Unit Class A

|     |            |          |   |   |
|-----|------------|----------|---|---|
| (B) | 3,405 shs. | 03/31/10 | - | - |
|-----|------------|----------|---|---|

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## 2012 Annual Report

## CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)

December 31, 2012

| Corporate Restricted Securities: (A)<br>(Continued)  | Principal<br>Amount,<br>Shares,<br>Units or<br>Ownership<br>Percentage | Acquisition<br>Date | Cost       | Fair Value |
|--|--|---------------------|------------|------------|
| <b>Sunrise Windows Holding Company</b>   |  |                     |            |            |
| A manufacturer and marketer of premium vinyl windows exclusively selling to the residential remodeling and replacement market.   |  |                     |            |            |
| 14% Senior Subordinated Note due 2017  | \$ 1,002,535   | 12/14/10            | \$ 956,535 | \$998,299  |
| 14% Senior Subordinated PIK Note due 2017  | \$ 78,837  | 08/14/12            | 75,492     | 78,504     |
| Common Stock (B)   | 38 shs.  | 12/14/10            | 38,168     | 16,878     |
| Warrant, exercisable until 2020, to purchase common stock at \$.01 per share (B)   | 37 shs.  | 12/14/10            | 37,249     | 16,471     |
|  |  |                     | 1,107,444  | 1,110,152  |
| <b>Synteract Holdings Corporation</b>  |  |                     |            |            |
| A provider of outsourced clinical trial management services to pharmaceutical and biotechnology companies.   |  |                     |            |            |
| 14.5% Senior Subordinated Note due 2017  | \$ 1,429,365   | 09/02/08            | 1,368,816  | 1,429,364  |
| Redeemable Preferred Stock Series A (B)  | 678 shs.   | 09/02/08            | 6,630      | 21,048     |
| Warrant, exercisable until 2018, to purchase common stock at \$.01 per share (B)   | 6,778 shs.   | 09/02/08            | 59,661     | -          |
|  |  |                     | 1,435,107  | 1,450,412  |
| <b>Terra Renewal LLC</b>   |  |                     |            |            |
| A provider of wastewater residual management and required environmental reporting, permitting, nutrient management planning and record keeping to companies involved in poultry and food processing. |  |                     |            |            |
| 12% Senior Subordinated Note due 2014 (D)  |  | \$664,062 *         | 644,369    | -          |
| 7.44% Term Note due 2013 (C)   |  | \$711,757           | 711,757    | 604,994    |
| 9.25% Term Note due 2013 (C)   |  | \$1,443             | 1,443      | 1,227      |
| Common Stock Class B   | 32 shs.  | *                   | 4,448      | -          |
| Limited Partnership Interest of Saw Mill Capital Fund V, LLC (B)   | 2.27% int.   | **                  | 117,464    | -          |
| Warrant, exercisable until 2016, to purchase common stock at \$.01 per share (B)   | 41 shs.  | 04/28/06            | 33,738     | -          |
| * 04/28/06 and 09/13/06.   |  |                     | 1,513,219  | 606,221    |
| **03/01/05 and 10/10/08.   |  |                     |            |            |
| <b>Torrent Group Holdings, Inc.</b>  |  |                     |            |            |

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A contractor specializing in the sales and installation of engineered drywells for the retention and filtration of stormwater and nuisance water flow.

|   |              |          |           |           |
|---|--------------|----------|-----------|-----------|
| 14.5% Senior Subordinated Note due 2014 (D) | \$ 1,300,003 | 10/26/07 | 1,136,835 | 1,243,168 |
| Series B Preferred Stock (B)                | 97 shs.      | 03/31/10 | -         | 97,664    |
| Common Stock (B)                            | 273 shs.     | 03/31/10 | 219,203   | -         |
|   |              |          | 1,356,038 | 1,340,832 |

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## Babson Capital Participation Investors

## CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)

December 31, 2012

| Corporate Restricted Securities: (A)<br>(Continued)  | Principal<br>Amount,<br>Shares,<br>Units or<br>Ownership<br>Percentage | Acquisition<br>Date | Cost       | Fair Value |
|--|--|---------------------|------------|------------|
| <b>Transpac Holding Company</b>  |  |                     |            |            |
| A designer, importer, and wholesaler of home décor and seasonal gift products.   |  |                     |            |            |
| 12% Senior Subordinated Note due 2015  | \$938,651  | 10/31/07            | \$ 893,322 | \$ 938,651 |
| Common Stock (B)   | 110 shs.   | 10/31/07            | 110,430    | -          |
| Warrant, exercisable until 2015, to purchase<br>common stock at \$.01 per share (B)  | 50 shs.  | 10/31/07            | 46,380     | -          |
|  |  |                     | 1,050,132  | 938,651    |
| <b>Tranzonic Companies (The)</b>   |  |                     |            |            |
| A producer of commercial and industrial supplies, such as safety products, janitorial supplies, work apparel,<br>washroom and restroom supplies and sanitary care products.              |  |                     |            |            |
| 13% Senior Subordinated Note due 2015  | \$ 542,400   | 02/05/98            | 541,372    | 542,400    |
| Common Stock (B)   | 315 shs.   | 02/04/98            | 315,000    | 276,243    |
| Warrant, exercisable until 2015, to purchase<br>common stock at \$.01 per share (B)  | 222 shs.   | 02/05/98            | 184,416    | 194,686    |
|  |  |                     | 1,040,788  | 1,013,329  |
| <b>Truck Bodies &amp; Equipment International</b>  |  |                     |            |            |
| A designer and manufacturer of accessories for heavy and medium duty trucks, primarily dump bodies, hoists, various<br>forms of flat-bed bodies, landscape bodies and other accessories. |  |                     |            |            |
| 12% Senior Subordinated Note due<br>2013   | \$ 1,222,698   | *                   | 1,166,255  | 1,221,562  |
| Preferred Stock Series B (B)   | 128 shs.   | 10/20/08            | 127,677    | 98,004     |
| Common Stock (B)   | 393 shs.   | *                   | 423,985    | -          |
| Warrant, exercisable until 2014, to<br>purchase<br>common stock at \$.02 per share (B)   | 81 shs.  | *                   | 84,650     | -          |
| Warrant, exercisable until 2018, to<br>purchase<br>common stock at \$.01 per share (B)   | 558 shs.   | 10/20/08            | -          | -          |
| * 07/19/05 and 12/22/05.   |  |                     | 1,802,567  | 1,319,566  |
| <b>TruStile Doors, Inc.</b>  |  |                     |            |            |
| A manufacturer and distributor of<br>interior doors.   |  |                     |            |            |
| Limited Liability Company Unit (B)   | 5,888 uts.   | 02/28/11            | 125,000    | 184,794    |
| Warrant, exercisable until 2013, to<br>purchase<br>common stock at \$.01 per share (B)   | 3,060 shs.   | 04/11/03            | 36,032     | 13,447     |
|  |  |                     | 161,032    | 198,241    |

U-Line Corporation

A manufacturer of high-end, built-in, undercounter ice making, wine storage and refrigeration appliances.

|  |          |          |                    |                    |
|--|----------|----------|--------------------|--------------------|
| Common Stock (B)   | 96 shs.  | 04/30/04 | 96,400             | 105,105            |
| Warrant, exercisable until 2016, to purchase common stock at \$.01 per share (B) | 122 shs. | 04/30/04 | 112,106<br>208,506 | 133,017<br>238,122 |

## 2012 Annual Report

## CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)

December 31, 2012

| Corporate Restricted Securities: (A) (Continued)   |              | Principal<br>Amount,<br>Shares,<br>Units or<br>Ownership<br>Percentage | Acquisition<br>Date | Cost       | Fair Value |
|--|--------------|--|---------------------|------------|------------|
| U M A Enterprises, Inc.<br>An importer and wholesaler of home décor products.  |              |  |                     |            |            |
| Convertible Preferred Stock (B)  | 470 shs.     |  | 02/08/08            | \$ 469,565 | \$ 786,975 |
| Vioneering, Inc.<br>A designer and manufacturer of tooling and fixtures for the aerospace industry.                  |              |  |                     |            |            |
| 10.5% Senior Secured Term  |              |  |                     |            |            |
| Loan due 2013  | \$ 414,706   |  | 05/17/07            | 414,084    | 411,123    |
| 13% Senior Subordinated Note   |              |  |                     |            |            |
| due 2014   | \$ 370,588   |  | 05/17/07            | 359,154    | 365,289    |
| 18% PIK Convertible Preferred  |              |  |                     |            |            |
| Stock (B)  | 21,361 shs.  |  | 03/13/09            | 41,440     | 23,419     |
| Common Stock (B)   |              |  |                     |            |            |
|  | 70,588 shs.  |  | 05/17/07            | 70,588     | -          |
| Warrant, exercisable until 2014,<br>to purchase  |              |  |                     |            |            |
| common stock at \$.01 per share  |              |  |                     |            |            |
| (B)  | 20,003 shs.  |  | 05/17/07            | 31,460     | -          |
|  |              |  |                     | 916,726    | 799,831    |
| Vitex Packaging Group, Inc.<br>A manufacturer of specialty packaging, primarily envelopes and tags used on tea bags. |              |  |                     |            |            |
| 10% Senior Subordinated PIK  |              |  |                     |            |            |
| Note due 2013  | \$ 111,931   |  | 10/29/09            | 111,872    | 230,623    |
| 5% Senior Subordinated PIK   |              |  |                     |            |            |
| Note due 2013 (D)  | \$ 476,866   |  | 06/30/07            | 470,305    | 476,866    |
| Class B Unit (B)   |              |  |                     |            |            |
|  | 406,525 uts. |  | 10/29/09            | 184,266    | -          |
| Class C Unit (B)   |              |  |                     |            |            |
|  | 450,000 uts. |  | 10/29/09            | 413,244    | 225,000    |
| Limited Liability Company Unit   |              |  |                     |            |            |
| Class A (B)  | 383,011 uts. |  | *                   | 229,353    | -          |
| Limited Liability Company Unit   |              |  |                     |            |            |
| Class B (B)  | 96,848 uts.  |  | 07/19/04            | 96,848     | -          |
|  |              |  |                     | 1,505,888  | 932,489    |
| * 07/19/04 and 10/29/09.   |              |  |                     |            |            |
| Wellborn Forest Holding<br>Company<br>A manufacturer of semi-custom kitchen and bath cabinetry.                      |              |  |                     |            |            |
| 12.13% Senior Subordinated   |              |  |                     |            |            |
| Note due 2016  | \$ 911,250   |  | 11/30/06            | 867,531    | 820,125    |
| Common Stock (B)   |              |  |                     |            |            |
|  | 101 shs.     |  | 11/30/06            | 101,250    | -          |



Warrant, exercisable until 2016,  
to purchase  
common stock at \$.01 per share

|     |         |          |           |         |
|-----|---------|----------|-----------|---------|
| (B) | 51 shs. | 11/30/06 | 45,790    | -       |
|     |         |          | 1,014,571 | 820,125 |

Wheaton Holding Corporation  
A distributor and manufacturer of laboratory supply products  
and packaging.

|                              |          |          |        |        |
|------------------------------|----------|----------|--------|--------|
| Preferred Stock Series B (B) | 703 shs. | 06/08/10 | 70,308 | 45,141 |
| Common Stock (B)             | 353 shs. | 06/08/10 | 353    | 22,636 |
|                              |          |          | 70,661 | 67,777 |

## Babson Capital Participation Investors

## CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)

December 31, 2012

| Corporate Restricted Securities: (A)<br>(Continued)  | Principal<br>Amount,<br>Shares,<br>Units or<br>Ownership<br>Percentage | Acquisition<br>Date | Cost                  | Fair Value            |
|--|--|---------------------|-----------------------|-----------------------|
| <b>Whitcraft Holdings, Inc.</b>  |  |                     |                       |                       |
| A leading independent manufacturer of precision formed, machined, and fabricated flight-critical aerospace components. |  |                     |                       |                       |
| 12% Senior Subordinated Note due 2018  | \$ 794,521   | 12/16/10            | \$ 740,244            | \$ 802,466            |
| Common Stock (B)   | 205 shs.   | 12/16/10            | 205,480               | 159,706               |
| Warrant, exercisable until 2018, to purchase common stock at \$.02 per share (B)                                       | 55 shs.  | 12/16/10            | 49,334                | 42,919                |
|  |  |                     | 995,058               | 1,005,091             |
| <b>Workplace Media Holding Company</b>   |  |                     |                       |                       |
| A direct marketer specializing in providing advertisers with access to consumers in the workplace.                     |  |                     |                       |                       |
| 13% Senior Subordinated Note due 2015 (D)  | \$ 654,247   | 05/14/07            | 601,454               | -                     |
| Limited Partnership Interest (B)   | 12.26% int.  | 05/14/07            | 61,308                | -                     |
| Warrant, exercisable until 2015, to purchase common stock at \$.02 per share (B)                                       | 47 shs.  | 05/14/07            | 44,186                | -                     |
|  |  |                     | 706,948               | -                     |
| <b>WP Supply Holding Corporation</b>   |  |                     |                       |                       |
| A distributor of fresh fruits and vegetables to grocery wholesalers and foodservice distributors in the upper Midwest. |  |                     |                       |                       |
| 14.5% Senior Subordinated Note due 2018  | \$ 874,960   | 11/03/11            | 859,697               | 885,264               |
| Common Stock (B)   | 1,500 shs.   | 11/03/11            | 150,000               | 113,915               |
|  |  |                     | 1,009,697             | 999,179               |
| <b>Total Private Placement Investments (E)</b>   |  |                     | <b>\$ 109,376,327</b> | <b>\$ 101,530,328</b> |



## 2012 Annual Report

## CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)

December 31, 2012

|   | Interest | Maturity | Shares or<br>Principal |            | Market     |
|---|----------|----------|------------------------|------------|------------|
| Corporate Restricted<br>Securities: (A) (Continued) | Rate     | Date     | Amount                 | Cost       | Value      |
| Rule 144A Securities -<br>4.33%:                    |          |          |                        |            |            |
| Bonds - 4.33%                                       |          |          |                        |            |            |
| ArcelorMittal                                       | 6.125 %  | 06/01/18 | \$ 500,000             | \$ 514,319 | \$ 506,750 |
| Calumet Specialty Products<br>Partners L.P.         | 9.625    | 08/01/20 | 500,000                | 491,326    | 543,750    |
| First Data Corporation                              | 7.375    | 06/15/19 | 250,000                | 250,000    | 258,750    |
| FMG Resources                                       | 7.000    | 11/01/15 | 250,000                | 257,077    | 262,500    |
| Hilcorp Energy Company                              | 7.625    | 04/15/21 | 325,000                | 311,689    | 354,250    |
| J.B. Poindexter Co., Inc.                           | 9.000    | 04/01/22 | 500,000                | 500,000    | 516,875    |
| MEG Energy Corporation                              | 6.375    | 01/30/23 | 500,000                | 500,000    | 521,250    |
| Penske Corporation                                  | 4.875    | 07/11/22 | 500,000                | 497,951    | 516,500    |
| Samson Investment<br>Company                        | 9.750    | 02/15/20 | 350,000                | 344,177    | 370,125    |
| ServiceMaster Company                               | 7.000    | 08/15/20 | 500,000                | 500,000    | 501,250    |
| Unit Corporation                                    | 6.625    | 05/15/21 | 500,000                | 493,981    | 513,125    |
| Valeant Pharmaceuticals<br>International            | 7.000    | 10/01/20 | 250,000                | 250,803    | 271,875    |
| Welltec A/S   | 8.000    | 02/01/19 | 375,000                | 368,045    | 397,500    |
| Total Bonds   |          |          |                        | 5,279,368  | 5,534,500  |
| Convertible Preferred Stock<br>- 0.00%              |          |          |                        |            |            |
| ETEX Corporation (B)                                |          |          | 194                    | -          | -          |
| Total Convertible Preferred<br>Stock                |          |          |                        | -          | -          |
| Preferred Stock - 0.00%                             |          |          |                        |            |            |
| TherOX, Inc. (B)                                    |          |          | 26                     | -          | -          |
| Total Preferred Stock                               |          |          |                        | -          | -          |

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Common Stock - 0.00%

|                                       |     |                |                |
|---------------------------------------|-----|----------------|----------------|
| Touchstone Health Partnership (B)     | 292 | -              | -              |
| Total Common Stock                    |     | -              | -              |
| Total Rule 144A Securities            |     | 5,279,368      | 5,534,500      |
| Total Corporate Restricted Securities |     | \$ 114,655,695 | \$ 107,064,828 |

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## Babson Capital Participation Investors

## CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)

December 31, 2012

| Corporate Public Securities -<br>22.14%: (A) | Interest<br>Rate | Maturity<br>Date | Principal<br>Amount | Cost       | Market<br>Value |
|--|------------------|------------------|---------------------|------------|-----------------|
| Bonds - 22.12%                               |                  |                  |                     |            |                 |
| Accuride Corp                                | 9.500 %          | 08/01/18         | \$ 500,000          | \$ 482,286 | \$ 482,500      |
| Alcoa, Inc.                                  | 6.150            | 08/15/20         | 600,000             | 629,744    | 655,286         |
| Alere, Inc.                                  | 9.000            | 05/15/16         | 300,000             | 314,922    | 316,500         |
| Alliant Techsystems Inc.                     | 6.875            | 09/15/20         | 500,000             | 537,148    | 549,375         |
| Ally Financial, Inc.                         | 5.500            | 02/15/17         | 750,000             | 765,245    | 802,322         |
| Alta Mesa Financial Services                 | 9.625            | 10/15/18         | 750,000             | 727,280    | 772,500         |
| Anglogold Holdings PLC                       | 5.375            | 04/15/20         | 600,000             | 605,271    | 619,237         |
| Avis Budget Car Rental                       | 9.750            | 03/15/20         | 375,000             | 375,000    | 433,125         |
| B E Aerospace, Inc.                          | 6.875            | 10/01/20         | 250,000             | 256,682    | 278,125         |
| Bank of America Corporation                  | 5.875            | 01/05/21         | 600,000             | 623,193    | 718,369         |
| Bill Barrett Corporation                     | 7.000            | 10/15/22         | 500,000             | 479,450    | 515,000         |
| Brunswick Corporation                        | 7.125            | 08/01/27         | 500,000             | 504,931    | 511,250         |
| C R H America, Inc.                          | 5.300            | 10/15/13         | 500,000             | 484,687    | 516,516         |
| Calumet Specialty Products<br>Partners L.P.  | 9.375            | 05/01/19         | 375,000             | 350,895    | 406,875         |
| CCO Holdings Capital<br>Corporation          | 5.250            | 09/30/22         | 500,000             | 495,118    | 506,250         |
| Centurytel, Inc.                             | 5.000            | 02/15/15         | 500,000             | 507,521    | 531,450         |
| CHC Helicopter SA                            | 9.250            | 10/15/20         | 1,000,000           | 929,409    | 1,052,500       |
| Chesapeake Energy<br>Corporation             | 6.775            | 03/15/19         | 375,000             | 368,931    | 375,469         |
| CIT Group, Inc.                              | 5.000            | 08/15/22         | 500,000             | 500,000    | 533,158         |
| Citigroup, Inc.                              | 5.500            | 04/11/13         | 500,000             | 495,523    | 505,152         |
| Continental Resources, Inc.                  | 5.000            | 09/15/22         | 500,000             | 511,517    | 538,750         |
| DaVita, Inc.                                 | 5.750            | 08/15/22         | 500,000             | 500,000    | 526,875         |
| Duke Realty Limited<br>Partnership           | 3.875            | 10/15/22         | 500,000             | 508,857    | 509,131         |
| Ensco PLC                                    | 3.250            | 03/15/16         | 600,000             | 598,488    | 636,238         |
| EP Energy/EP Finance, Inc.                   | 9.375            | 05/01/20         | 500,000             | 508,313    | 563,750         |
| Equifax, Inc.                                | 4.450            | 12/01/14         | 500,000             | 507,840    | 527,185         |
| GATX Corporation                             | 4.750            | 05/15/15         | 500,000             | 503,412    | 534,243         |
|  | 5.500            | 01/08/20         | 500,000             | 498,506    | 591,855         |

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General Electric Capital Corporation

|                               |       |          |         |         |         |
|-------------------------------|-------|----------|---------|---------|---------|
| Goldman Sachs Group, Inc.     | 4.750 | 07/15/13 | 500,000 | 489,058 | 510,486 |
| Headwaters, Inc.              | 7.625 | 04/01/19 | 305,000 | 305,138 | 324,063 |
| Health Management Association | 6.125 | 04/15/16 | 250,000 | 256,372 | 270,000 |
| HealthSouth Corporation       | 7.750 | 09/15/22 | 450,000 | 451,044 | 493,313 |
| Hertz Corporation             | 6.750 | 04/15/19 | 220,000 | 216,955 | 240,075 |
| International Game Technology | 7.500 | 06/15/19 | 500,000 | 499,796 | 591,872 |
| Jabil Circuit, Inc.           | 4.700 | 09/15/22 | 500,000 | 499,960 | 525,625 |
| Kraft Foods, Inc.             | 5.375 | 02/10/20 | 500,000 | 513,304 | 603,630 |

## 2012 Annual Report

## CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)

December 31, 2012

| Corporate Public Securities:<br>(A) (Continued) | Interest<br>Rate | Maturity<br>Date | Shares or<br>Principal<br>Amount | Cost          | Market<br>Value |
|---|------------------|------------------|----------------------------------|---------------|-----------------|
| Masco Corporation                               | 7.125 %          | 03/15/20         | 350,000                          | \$ 349,996    | \$ 407,201      |
| Morgan Stanley                                  | 5.500            | 01/26/20         | 500,000                          | 497,941       | 560,897         |
| NBC Universal Media LLC                         | 5.150            | 04/30/20         | 500,000                          | 499,439       | 592,727         |
| Nexeo Solutions LLC                             | 8.375            | 03/01/18         | 20,000                           | 20,000        | 18,900          |
| Niska Gas Storage Partners<br>LLC               | 8.875            | 03/15/18         | 500,000                          | 505,867       | 513,750         |
| Omnova Solutions, Inc.                          | 7.875            | 11/01/18         | 750,000                          | 764,079       | 773,437         |
| Peabody Energy Corporation                      | 6.000            | 11/15/18         | 500,000                          | 500,587       | 531,250         |
| Perry Ellis International, Inc.                 | 7.875            | 04/01/19         | 375,000                          | 371,479       | 391,875         |
| Precision Drilling<br>Corporation               | 6.625            | 11/15/20         | 250,000                          | 257,482       | 268,750         |
| Qwest Diagnostic, Inc.                          | 4.750            | 01/30/20         | 500,000                          | 498,990       | 552,173         |
| Sealed Air Corporation                          | 7.875            | 06/15/17         | 500,000                          | 494,837       | 533,125         |
| Sprint Nextel Corporation                       | 6.000            | 12/01/16         | 500,000                          | 511,625       | 543,750         |
| Steelcase, Inc.                                 | 6.375            | 02/15/21         | 500,000                          | 507,493       | 532,688         |
| Tech Data Corporation                           | 3.750            | 09/21/17         | 500,000                          | 507,087       | 512,904         |
| Thermadyne Holdings<br>Corporation              | 9.000            | 12/15/17         | 250,000                          | 264,615       | 266,250         |
| Time Warner Cable, Inc.                         | 5.000            | 02/01/20         | 500,000                          | 492,234       | 582,167         |
| Tyson Foods, Inc.                               | 4.500            | 06/15/22         | 500,000                          | 516,145       | 541,258         |
| Weatherford International<br>Limited            | 4.500            | 04/15/22         | 500,000                          | 521,137       | 530,630         |
| Total Bonds                                     |                  |                  |                                  | 26,330,564    | 28,286,179      |
| Common Stock - 0.02%                            |                  |                  |                                  |               |                 |
| Intrepid Potash, Inc. (B)                       |                  |                  | 185                              | \$ 5,920      | 3,939           |
| Nortek, Inc. (B)                                |                  |                  | 100                              | 1             | 6,625           |
| Rue21, Inc. (B)                                 |                  |                  | 350                              | 6,650         | 9,937           |
| Total Common Stock                              |                  |                  |                                  | 12,571        | 20,501          |
| Total Corporate Public<br>Securities            |                  |                  |                                  | \$ 26,343,135 | \$ 28,306,680   |





## Babson Capital Participation Investors

## CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)

December 31, 2012

|                                | Interest<br>Rate/Yield <sup>^</sup> | Maturity<br>Date | Principal<br>Amount | Cost           | Fair<br>Value  |
|--------------------------------|-------------------------------------|------------------|---------------------|----------------|----------------|
| Short-Term Securities:         |                                     |                  |                     |                |                |
| Commercial Paper -<br>5.86%    |                                     |                  |                     |                |                |
| MidAmerican Energy<br>Holdings | 0.310 %                             | 01/11/13         | \$ 2,500,000        | \$ 2,499,785   | \$ 2,499,785   |
| Pentair Finance SA             | 0.400                               | 01/07/13         | 2,500,000           | 2,499,833      | 2,499,833      |
| Ryder System, Inc.             | 0.300                               | 01/15/13         | 2,500,000           | 2,499,708      | 2,499,708      |
| Total Short-Term<br>Securities |                                     |                  |                     | \$ 7,499,326   | \$ 7,499,326   |
| Total Investments              | 111.73 %                            |                  |                     | \$ 148,498,156 | \$ 142,870,834 |
| Other Assets                   | 3.71                                |                  |                     |                | 4,749,776      |
| Liabilities                    | (15.44 )                            |                  |                     |                | (19,746,485 )  |
| Total Net Assets               | 100.00 %                            |                  |                     |                | \$ 127,874,125 |

(A) In each of the convertible note, warrant, and common stock investments, the issuer has agreed to provide certain registration rights.

(B) Non-income producing security.

(C) Variable rate security; rate indicated is as of December 31, 2012.

(D) Defaulted security; interest not accrued.

(E) Illiquid security. As of December 31, 2012, the values of these securities amounted to \$101,530,328 or 79.40% of net assets.

<sup>^</sup>Effective yield at purchase

PIK - Payment-in-kind

## 2012 Annual Report

## CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)

December 31, 2012

| Industry Classification:                        | Fair Value/<br>Market Value | Fair Value/<br>Market Value |
|---|-----------------------------|-----------------------------|
| <b>AEROSPACE - 2.75%</b>                        |                             |                             |
| A E Company, Inc.                               | \$ 275,843                  |                             |
| Alliant Techsystems Inc.                        | 549,375                     |                             |
| B E Aerospace, Inc.                             | 278,125                     |                             |
| Merex Holding Corporation                       | 611,157                     |                             |
| Visioneering, Inc.                              | 799,831                     |                             |
| Whitcraft Holdings, Inc.                        | 1,005,091                   |                             |
|   | 3,519,422                   |                             |
| <b>AUTOMOBILE - 6.23%</b>                       |                             |                             |
| Accuride Corp                                   | 482,500                     |                             |
| Avis Budget Car Rental                          | 433,125                     |                             |
| DPL Holding Corporation                         | 1,636,993                   |                             |
| Ideal Tridon Holdings, Inc.                     | 1,064,907                   |                             |
| J A C Holding Enterprises, Inc.                 | 912,255                     |                             |
| Jason Partners Holdings LLC                     | 25,511                      |                             |
| Johnson Controls, Inc.                          | 564,397                     |                             |
| K & N Parent, Inc.                              | 1,081,658                   |                             |
| Ontario Drive & Gear Ltd.                       | 961,988                     |                             |
| Penske Corporation                              | 516,500                     |                             |
| Qualis Automotive LLC                           | 285,065                     |                             |
|   | 7,964,899                   |                             |
| <b>BEVERAGE, DRUG &amp; FOOD - 7.71%</b>        |                             |                             |
| 1492 Acquisition LLC                            | 1,243,496                   |                             |
| Eatem Holding Company                           | 1,115,345                   |                             |
| F F C Holding Corporation                       | 1,182,261                   |                             |
| Golden County Foods Holding, Inc.               | -                           |                             |
| Hospitality Mints Holding Company               | 1,562,366                   |                             |
| JMH Investors LLC                               | 1,237,594                   |                             |
| Kraft Foods, Inc.                               | 603,630                     |                             |
| <b>BROADCASTING &amp; ENTERTAINMENT - 0.92%</b> |                             |                             |
| HOP Entertainment LLC                           | \$ -                        |                             |
| NBC Universal Media LLC                         | 592,727                     |                             |
| Time Warner Cable, Inc.                         | 582,167                     |                             |
| Sundance Investco LLC                           | -                           |                             |
| Workplace Media Holding Company                 | -                           |                             |
|   | 1,174,894                   |                             |
| <b>BUILDINGS &amp; REAL ESTATE - 1.74%</b>      |                             |                             |
| ACP Cascade Holdings LLC                        | -                           |                             |
| Duke Realty Limited Partnership                 | 509,131                     |                             |
| Masco Corporation                               | 407,201                     |                             |
| Sunrise Windows Holding Company                 | 1,110,152                   |                             |
| TruStile Doors, Inc.                            | 198,241                     |                             |
|   | 2,224,725                   |                             |
| <b>CHEMICAL, PLASTICS &amp; RUBBER - 1.58%</b>  |                             |                             |
| Capital Specialty Plastics, Inc.                | 515,888                     |                             |
| Nicoat Acquisitions LLC                         | 729,485                     |                             |
| Omnova Solutions, Inc.                          | 773,437                     |                             |
|   | 2,018,810                   |                             |
| <b>CONSUMER PRODUCTS - 8.01%</b>                |                             |                             |
| AMS Holding LLC                                 | 1,250,911                   |                             |
| Baby Jogger Holdings LLC                        | 1,073,834                   |                             |
| Bravo Sports Holding Corporation                | 630,843                     |                             |
| Custom Engineered Wheels, Inc.                  | 1,319,242                   |                             |
| Handi Quilter Holding Company                   | 558,842                     |                             |
| K N B Holdings Corporation                      | 2,291,638                   |                             |
| Manhattan Beachwear Holding Company             | 889,476                     |                             |
| Perry Ellis International, Inc.                 | 391,875                     |                             |
| R A J Manufacturing Holdings LLC                | 818,800                     |                             |

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|                                  |           |                           |            |
|----------------------------------|-----------|---------------------------|------------|
| Snacks Parent Corporation        | 1,073,758 | Tranzonic Companies (The) | 1,013,329  |
| Spartan Foods Holding<br>Company | 1,185,927 |                           | 10,238,790 |
| Specialty Commodities, Inc.      | 113,238   |                           |            |
| Tyson Foods, Inc.                | 541,258   |                           |            |
|                                  | 9,858,873 |                           |            |

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## Babson Capital Participation Investors

## CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)

December 31, 2012

| Industry Classification: (Continued)   | Fair Value/<br>Market Value | Fair Value/<br>Market Value       |            |
|--|-----------------------------|-----------------------------------|------------|
| CONTAINERS, PACKAGING & GLASS - 5.07%  |                             | DIVERSIFIED/CONGLOMERATE,         |            |
| Flutes, Inc.                           | \$ 498,551                  | SERVICE - 10.05%                  |            |
| P K C Holding Corporation              | 1,915,312                   | A S C Group, Inc.                 | \$ 410,366 |
| P P T Holdings LLC                     | 1,106,871                   | A W X Holdings Corporation        | 378,000    |
| Paradigm Packaging, Inc.               | 875,405                     | Advanced Technologies Holdings    | 729,586    |
| Rose City Holding Company              | 622,176                     | Anglogold Holdings PLC            | 619,237    |
| Sealed Air Corporation                 | 533,125                     | Apex Analytix Holding Corporation | 1,168,962  |
| Vitex Packaging Group, Inc.            | 932,489                     | Bank of America Corporation       | 718,369    |
|  | 6,483,929                   | C R H America, Inc.               | 516,516    |
| DISTRIBUTION - 4.20%                   |                             | Church Services Holding Company   | 575,876    |
| Blue Wave Products, Inc.               | 681,857                     | Clough, Harbour and Associates    | 252,298    |
| BP SCI LLC                             | 1,239,481                   | Crane Rental Corporation          | 1,208,079  |
| Duncan Systems, Inc.                   | 586,019                     | ELT Holding Company               | 1,053,764  |
| RM Holding Company                     | 617,395                     | Equifax, Inc.                     | 527,185    |
| Stag Parkway Holding Co.               | 1,246,720                   | HVAC Holdings, Inc.               | 1,255,931  |
| WP Supply Holding Corporation          | 999,179                     | Insurance Claims Management, Inc. | 167,951    |
|  | 5,370,651                   | Mail Communications Group, Inc.   | 305,973    |
| DIVERSIFIED/CONGLOMERATE,              |                             | Nexeo Solutions LLC               | 18,900     |
| MANUFACTURING - 12.84%                 |                             | Northwest Mailing Services, Inc.  | 1,639,816  |
| A H C Holding Company, Inc.            | 1,582,972                   | Pearlman Enterprises, Inc.        | -          |
| Advanced Manufacturing Enterprises LLC | 1,244,323                   | Safety Infrastructure Solutions   | 801,809    |
| Arrow Tru-Line Holdings, Inc.          | 762,004                     | ServiceMaster Company             | 501,250    |
| C D N T, Inc.                          | 705,251                     |                                   | 12,849,868 |
| F G I Equity LLC                       | 313,365                     | ELECTRONICS - 1.64%               |            |
| G C Holdings                           | 1,435,172                   | Connecticut Electric, Inc.        | 1,063,137  |
| HGGC Citadel Plastics Holding          | 1,038,578                   | Jabil Circuit, Inc.               | 525,625    |
| J.B. Poindexter Co., Inc.              | 516,875                     | Tech Data Corporation             | 512,904    |
| K P H I Holdings, Inc.                 | 1,150,092                   |                                   | 2,101,666  |
| K P I Holdings, Inc.                   | 1,560,657                   | FINANCIAL SERVICES - 6.73%        |            |
| LPC Holding Company                    | 1,297,613                   | Ally Financial, Inc.              | 802,322    |
| MEGTEC Holdings, Inc.                  | 361,759                     |                                   | 772,500    |

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|   |            |   |           |
|---|------------|---|-----------|
|   |            | Alta Mesa Financial<br>Services         |           |
| Nortek, Inc.                              | 6,625      | CIT Group, Inc.                         | 533,158   |
| O E C Holding Corporation                 | 482,688    | Citigroup, Inc.                         | 505,152   |
| Postle Aluminum Company LLC               | 2,641,642  | GATX Corporation                        | 534,243   |
| Truck Bodies & Equipment<br>International | 1,319,566  | General Electric Capital<br>Corporation | 591,855   |
|   | 16,419,182 | Goldman Sachs Group, Inc.               | 510,486   |
|   |            | Morgan Stanley                          | 560,897   |
|   |            | Pentair Finance SA                      | 2,499,833 |
|   |            | REVSpring, Inc.                         | 1,292,587 |
|   |            |   | 8,603,033 |

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## CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)

December 31, 2012

| Industry Classification:<br>(Continued)   | Fair Value/<br>Market Value |   | Fair Value/<br>Market Value |
|---|-----------------------------|---|-----------------------------|
| HEALTHCARE, EDUCATION & CHILDCARE - 8.64%                                       |                             | MACHINERY - 4.87%   |                             |
| Alere, Inc.   | \$ 316,500                  | ABC Industries, Inc.  | \$ 600,740                  |
| American Hospice<br>Management Holding LLC                                      | 2,119,983                   | Arch Global Precision LLC   | 1,142,177                   |
| CHG Alternative Education<br>Holding Company                                    | 1,016,935                   | E S P Holdco, Inc.  | 1,493,761                   |
| DaVita, Inc.  | 526,875                     | M V I Holding, Inc.   | 140,498                     |
| GD Dental Services LLC  | 1,254,772                   | Motion Controls Holdings  | 1,027,499                   |
| Healthcare Direct Holding<br>Company  | 702,121                     | NetShape Technologies, Inc.<br>Pacific Consolidated Holdings<br>LLC | 1,115,114<br>42,187         |
| HealthSouth Corporation   | 493,313                     | Thermadyne Holdings<br>Corporation                                  | 266,250                     |
| Marshall Physicians Services<br>LLC   | 501,720                     | Welltec A/S   | 397,500                     |
| Qwest Diagnostic, Inc.  | 552,173                     |   | 6,225,726                   |
| SouthernCare Holdings, Inc.<br>Strata/WLA Holding<br>Corporation                | 1,050,108<br>993,782        | MEDICAL DEVICES/BIOTECH - 3.02%                                     |                             |
| Synteract Holdings<br>Corporation   | 1,450,412                   | E X C Acquisition Corporation                                       | 18,452                      |
| Touchstone Health<br>Partnership  | -                           | ETEX Corporation<br>Health Management<br>Association                | -<br>270,000                |
| Wheaton Holding<br>Corporation  | 67,777<br>11,046,471        | MedSystems Holdings LLC<br>MicroGroup, Inc.                         | 742,635<br>225,682          |
| HOME & OFFICE FURNISHINGS, HOUSEWARES,<br>AND DURABLE CONSUMER PRODUCTS - 3.87% |                             | NT Holding Company<br>Precision Wire Holding<br>Company             | 1,048,357<br>1,559,077      |
| Connor Sport Court<br>International, Inc.                                       | 1,283,085                   | TherOX, Inc.  | -                           |
| H M Holding Company   | 36,270                      |   | 3,864,203                   |
| Home Décor Holding<br>Company   | 318,587                     | MINING, STEEL, IRON &<br>NON-PRECIOUS<br>METALS - 1.13%             |                             |
| Monessen Holding<br>Corporation   | -                           | Alcoa, Inc.   | 655,286                     |
| Steelcase, Inc.   | 532,688                     | FMG Resources   | 262,500                     |
| Transpac Holding Company  | 938,651                     | Peabody Energy Corporation  | 531,250                     |
| U-Line Corporation  | 238,122                     |   | 1,449,036                   |
| U M A Enterprises, Inc.   | 786,975                     |   |                             |
| Wellborn Forest Holding<br>Company  | 820,125<br>4,954,503        |   |                             |

|   |           |                             |           |
|---|-----------|-----------------------------|-----------|
|   |           | NATURAL RESOURCES -         |           |
|   |           | 2.61%                       |           |
| LEISURE, AMUSEMENT, ENTERTAINMENT - 0.86% |           | ArcelorMittal               | 506,750   |
| Brunswick Corporation                     | 511,250   | Headwaters, Inc.            | 324,063   |
| International Game                        |           |                             |           |
| Technology                                | 591,872   | Intrepid Potash, Inc.       | 3,939     |
|   | 1,103,122 | MidAmerican Energy Holdings | 2,499,785 |
|   |           |                             | 3,334,537 |



## Babson Capital Participation Investors

## CONSOLIDATED SCHEDULE OF INVESTMENTS (CONTINUED)

December 31, 2012

| Industry Classification:<br>(Continued)  | Fair Value/<br>Market Value |                                      | Fair Value/<br>Market Value |
|--|-----------------------------|--------------------------------------|-----------------------------|
| OIL & GAS - 7.82%                        |                             | TRANSPORTATION - 4.08%               |                             |
| Bill Barrett Corporation                 | \$ 515,000                  | CHC Helicopter SA                    | \$ 1,052,500                |
| Calumet Specialty Products Partners L.P. | 950,625                     | Hertz Corporation                    | 240,075                     |
| Chesapeake Energy Corporation            | 375,469                     | MNX Holding Company                  | 1,245,350                   |
| Continental Resources, Inc.              | 538,750                     | NABCO, Inc.                          | 177,544                     |
| Ensco PLC                                | 636,238                     | Ryder System, Inc.                   | 2,499,708                   |
| EP Energy/EP Finance, Inc.               | 563,750                     |                                      | 5,215,177                   |
| Hilcorp Energy Company                   | 354,250                     | WASTE MANAGEMENT / POLLUTION - 1.52% |                             |
| International Offshore Services LLC      | 270,000                     | Terra Renewal LLC                    | 606,221                     |
| MBWS Ultimate Holdco, Inc.               | 1,828,861                   | Torrent Group Holdings, Inc.         | 1,340,832                   |
| MEG Energy Corporation                   | 521,250                     |                                      | 1,947,053                   |
| Niska Gas Storage Partners LLC           | 513,750                     |                                      |                             |
| Petroplex Inv Holdings LLC               | 1,243,063                   |                                      |                             |
| Precision Drilling Corporation           | 268,750                     |                                      |                             |
| Samson Investment Company                | 370,125                     | Total Investments - 111.73%          | \$ 142,870,834              |
| Unit Corporation                         | 513,125                     |                                      |                             |
| Weatherford International Limited        | 530,630                     |                                      |                             |
|  | 9,993,636                   |                                      |                             |
| PHARMACEUTICALS - 0.56%                  |                             |                                      |                             |
| CorePharma LLC                           | 445,611                     |                                      |                             |
| Valeant Pharmaceuticals International    | 271,875                     |                                      |                             |
|  | 717,486                     |                                      |                             |
| RETAIL STORES - 0.01%                    |                             |                                      |                             |
| Rue21, Inc.                              | 9,937                       |                                      |                             |
| TECHNOLOGY - 1.42%                       |                             |                                      |                             |
| First Data Corporation                   | 258,750                     |                                      |                             |
| Sencore Holding Company                  | -                           |                                      |                             |
| Smart Source Holdings LLC                | 1,558,192                   |                                      |                             |
|  | 1,816,942                   |                                      |                             |
| TELECOMMUNICATIONS - 1.85%               |                             |                                      |                             |
| All Current Holding Company              | 782,813                     |                                      |                             |
| CCO Holdings Capital Corporation         | 506,250                     |                                      |                             |
| Centurytel, Inc.                         | 531,450                     |                                      |                             |
| Sprint Nextel Corporation                | 543,750                     |                                      |                             |
|  | 2,364,263                   |                                      |                             |



## 2012 Annual Report

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## 1. History

Babson Capital Participation Investors (the “Trust”) was organized as a Massachusetts business trust under the laws of the Commonwealth of Massachusetts pursuant to a Declaration of Trust dated April 7, 1988. Effective December 16, 2011, the Trust’s name was changed to Babson Capital Participation Investors. Prior to December 16, 2011, the Trust’s name was MassMutual Participation Investors.

The Trust is a diversified closed-end management investment company. Babson Capital Management LLC (“Babson Capital”), a wholly-owned indirect subsidiary of Massachusetts Mutual Life Insurance Company (“MassMutual”), acts as its investment adviser. 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 capital. In addition, the Trust may temporarily invest in high quality, readily marketable securities.

On January 27, 1998, the Board of Trustees authorized the formation of a wholly-owned subsidiary of the Trust (“PI Subsidiary Trust”) for the purpose of holding certain investments. The results of the PI Subsidiary Trust are consolidated in the accompanying financial statements. Footnote 2.D below discusses the Federal tax consequences of the PI Subsidiary Trust.

Trust’s securities and has delegated responsibility for applying those procedures to Babson Capital. Babson Capital has established a Pricing Committee which is responsible for setting the guidelines used in following the procedures adopted by the Trustees ensuring that those guidelines are being followed. Babson Capital considers all relevant factors that are reasonably available, through either public information or information available to Babson Capital, when determining the fair value of a security. The Trustees meet at least once each quarter to approve the value of the Trust’s portfolio securities as of the close of business on the last business day of the preceding quarter. This valuation requires the approval of a majority of the Trustees of the Trust, including a majority of the Trustees who are not interested persons of the Trust or of Babson Capital. In approving valuations, the Trustees will consider reports by Babson Capital analyzing each portfolio security in accordance with the procedures and guidelines referred to above, which include the relevant factors referred to below. Babson Capital has agreed to provide such reports to the Trust at least quarterly. The consolidated financial statements include private placement restricted securities valued at \$101,530,328 (79.40% of net assets) as of December 31, 2012 whose values have been estimated by the Trustees based on the process described above in the absence of readily ascertainable market values. Due to the inherent uncertainty of valuation, those estimated values may differ significantly from the values that would have been used had a ready market for the securities existed, and the differences could be material.

Following is a description of valuation methodologies used for assets recorded at fair value.

#### Corporate Public Securities – Corporate Bonds, Preferred Stocks and Common Stocks

The Trust uses external independent third-party pricing services to determine the fair values of its Corporate Public Securities. At December 31, 2012, 100% of the carrying value of these investments was from external pricing services. In the event that the primary pricing service does not provide a price, the Trust utilizes the pricing provided by a secondary pricing service.

## 2. Significant Accounting Policies

The following is a summary of significant accounting policies followed consistently by the Trust in the preparation of its consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (“U.S. GAAP”).

### A. Fair Value Measurements:

Under U.S. GAAP, fair value represents the price that should be received to sell an asset (exit price) in an orderly transaction between market participants at the measurement date.

#### Determination of Fair Value

The determination of the fair value of the Trust’s investments is the responsibility of the Trust’s Board of Trustees (the “Trustees”). The Trustees have adopted procedures for the valuation of the

Public debt securities generally trade in the over-the-counter market rather than on a securities exchange. The Trust’s pricing services use multiple valuation techniques to determine fair value. In instances where significant market activity exists, the pricing services may utilize a market based approach through which quotes from market makers are used to determine fair value. In instances where significant market activity may not exist or is limited, the pricing services also utilize proprietary valuation models which may consider market characteristics such as benchmark yield curves, option adjusted spreads, credit spreads, estimated default rates, coupon rates, anticipated timing of principal underlying prepayments, collateral, and other unique security features in order to estimate the relevant cash flows, which are then discounted to calculate the fair value.

## Babson Capital Participation Investors

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Public equity securities listed on an exchange or on the NASDAQ National Market System are valued at the last quoted sales price of that day.

Annually, Babson Capital conducts reviews of the primary pricing vendors to validate that the inputs used in that vendors' pricing process are deemed to be market observable as defined in the standard. While Babson Capital is not provided access to proprietary models of the vendors, the reviews have included on-site walk-throughs of the pricing process, methodologies and control procedures for each asset class and level for which prices are provided. The review also included an examination of the underlying inputs and assumptions for a sample of individual securities across asset classes, credit rating levels and various durations, a process Babson Capital continues to perform annually. In addition, the pricing vendors have an established challenge process in place for all security valuations, which facilitates identification and resolution of prices that fall outside expected ranges. Babson Capital believes that the prices received from the pricing vendors are representative of prices that would be received to sell the assets at the measurement date (exit prices) and are classified appropriately in the hierarchy.

## Corporate Restricted Securities – Corporate Bonds

The fair value of certain notes is determined using an internal model that discounts the anticipated cash flows of those notes using a specific discount rate. Changes to that discount rate are driven by changes in general interest rates, probabilities of default and credit adjustments. The discount rate used within the models to discount the future anticipated cash flows is considered a significant unobservable input. Significant increases/(decreases) in the discount rate would result in a significant (decrease)/ increase to the notes' fair value.

The fair value of certain distressed notes is based on an enterprise waterfall methodology which is discussed in the equity security valuation section

Both the company's EBITDA and valuation multiple as well as the discount are considered significant unobservable inputs. Significant increases / (decreases) to the company's trailing twelve months EBITDA and / or the valuation multiple would result in significant increases / (decreases) to the equity value. An increase / (decrease) to the discount would result in a (decrease) / increase to the equity value.

## Short-Term Securities

Short-term securities, of sufficient credit quality, with more than sixty days to maturity are valued at fair value, using external independent third-party services. Short-term securities having a maturity of sixty days or less are valued at amortized cost, which approximates fair value.

## Quantitative Information about Level 3 Fair Value Measurements

The following table represents quantitative information about Level 3 fair value measurements as of December 31, 2012.

|                   | Valuation Technique   | Unobservable Inputs                | Range                            | Weighted Average |
|-------------------|-----------------------|------------------------------------|----------------------------------|------------------|
| Corporate Bonds   | Discounted Cash Flows | Discount Rate                      | 0.2% to 16.1%                    | 12.2%            |
| Equity Securities | Market Approach       | Valuation Multiple                 | 3.3x to 9.9x                     | 6.3x             |
|                   |                       | Discount for lack of marketability | 0% to 5%                         | 3.8%             |
|                   |                       | EBITDA                             | \$2.2 million to \$142.4 million | 22.2 million     |

## Fair Values Hierarchy

The Trust categorizes its investments measured at fair value in three levels, based on the inputs and assumptions used to determine fair value. These levels are as follows:

below.

Corporate Restricted Securities – Common Stock,  
Preferred Stock and Partnerships & LLC's

The fair value of equity securities is determined using an enterprise waterfall methodology. Under this methodology, the enterprise value of the company is first estimated and that value is then allocated to the company's outstanding debt and equity securities based on the documented priority of each class of securities in the capital structure. Generally, the waterfall proceeds from senior debt tranches of the capital structure to senior then junior subordinated debt, followed by each class of preferred stock and finally the common stock.

To estimate a company's enterprise value, the company's trailing twelve months earnings before interest, taxes, depreciation and amortization ("EBITDA") is multiplied by a valuation multiple. A discount for lack of marketability is applied to the end result.

Level 1: quoted prices in active markets for identical securities  
Level 2: other significant observable inputs (including quoted prices for similar securities, interest rates, prepayment speeds, credit risk, etc.)  
Level 3: significant unobservable inputs (including the Trust's own assumptions in determining the fair value of investments)

## 2012 Annual Report

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The following is a summary of the inputs used to value the Trust's net assets as of December 31, 2012:

| Assets:               | Total          | Level 1   | Level 2       | Level 3        |
|-----------------------|----------------|-----------|---------------|----------------|
| Restricted Securities |                |           |               |                |
| Corporate Bonds       | \$ 86,595,256  | \$ -      | \$ 5,534,500  | \$ 81,060,756  |
| Common Stock - U.S.   | 7,793,109      | -         | -             | 7,793,109      |
| Preferred Stock       | 5,786,187      | -         | -             | 5,786,187      |
| Partnerships and LLCs | 6,890,276      | -         | -             | 6,890,276      |
| Public Securities     |                |           |               |                |
| Corporate Bonds       | 28,286,179     | -         | 28,286,179    | -              |
| Common Stock - U.S.   | 20,501         | 20,501    | -             | -              |
| Short-term Securities | 7,499,326      | -         | 7,499,326     | -              |
| Total                 | \$ 142,870,834 | \$ 20,501 | \$ 41,320,005 | \$ 101,530,328 |

See information disaggregated by security type and industry classification in the Consolidated Schedule of Investments.

There were no transfers into or out of Level 1 or Level 2 assets.

Following is a reconciliation of Level 3 assets for which significant unobservable inputs were used to determine fair value:

| Assets:               | Beginning balance at 12/31/2011 | Included in earnings | Purchases    | Sales          | Prepayments    | Transfers into Level 3 | Transfers out of Level 3 | Ending balance at 12/31/2012 |
|-----------------------|---------------------------------|----------------------|--------------|----------------|----------------|------------------------|--------------------------|------------------------------|
| Restricted Securities |                                 |                      |              |                |                |                        |                          |                              |
| Corporate Bonds       | \$84,969,256                    | \$ 1,756,136         | \$24,959,545 | \$(13,192,548) | \$(17,431,633) | \$-                    | \$-                      | \$81,060,756                 |
| Common Stock - U.S.   | 9,972,142                       | 2,061,866            | 1,140,298    | (5,381,197)    | -              | -                      | -                        | 7,793,109                    |
| Preferred Stock       | 5,965,999                       | 632,738              | 1,151,556    | (1,964,106)    | -              | -                      | -                        | 5,786,187                    |
| Partnerships and LLCs | 6,021,318                       | 1,244,966            | 974,131      | (1,350,139)    | -              | -                      | -                        | 6,890,276                    |
|                       | \$106,928,715                   | \$5,695,706          | \$28,225,530 | \$(21,887,990) | \$(17,431,633) | \$-                    | \$-                      | \$101,530,328                |

Income, Gains and Losses included in Net Increase in Net Assets resulting from Operations for the period are presented in the following accounts on the Statement of Operations for Level 3 assets:

| Net Increase in Net Assets Resulting from Operations | Change in Unrealized Gains & (Losses) in Net Assets from assets still held |
|--|--|
|--|--|

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|  |           |           |
|--|-----------|-----------|
| Interest (Amortization)  | 690,657   | -         |
| Net realized gain on<br>investments before taxes                         | 2,759,405 | -         |
| Net change in unrealized<br>depreciation of investments<br>before taxes. | 2,245,644 | 4,169,496 |

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## Babson Capital Participation Investors

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

**B. Accounting for Investments:**

Investment transactions are accounted for on the trade date. Dividend income is recorded on the ex-dividend date. Interest income is recorded on the accrual basis, including the amortization of premiums and accretion of discounts on bonds held using the yield-to-maturity method. The Trust does not accrue income when payment is delinquent and when management believes payment is questionable.

Realized gains and losses on investment transactions and unrealized appreciation and depreciation of investments are reported for financial statement and Federal income tax purposes on the identified cost method.

**C. Use of Estimates:**

The preparation of financial statements in conformity with U.S. 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 revenues and expenses during the reporting period. Actual results could differ from those estimates.

**D. Federal Income Taxes:**

The Trust has elected to be taxed as a "regulated investment company" under the Internal Revenue Code, and intends to maintain this qualification and to distribute substantially all of its net taxable income to its shareholders. In any year when net long-term capital gains are realized by the Trust, management, after evaluating the prevailing economic conditions, will recommend that Trustees either designate the net realized long-term gains as undistributed and pay the federal capital gains taxes thereon, or distribute all or a portion of such net gains. For the year ended December 31, 2012, the Trust had a net realized taxable

taxable earnings due to earnings from the PI Subsidiary Trust as well as certain permanent and temporary differences in the recognition of income and realized gains or losses on certain investments. Permanent differences will result in reclassifications to the capital accounts. In 2012, the Trust increased undistributed net investment income by \$239,577, decreased accumulated net realized gains by \$781,769, increased retained net realized gain on investments, prior years by \$549,895 and decreased additional paid in capital by \$7,703 to more accurately display the Trust's capital financial position on a tax-basis in accordance with U.S. GAAP. These re-classifications had no impact on net asset value.

The PI Subsidiary Trust is not taxed as a regulated investment company. Accordingly, prior to the Trust receiving any distributions from the PI Subsidiary Trust, all of the PI Subsidiary Trust's taxable income and realized gains, including non-qualified income and realized gains, is subject to taxation at prevailing corporate tax rates.

The components of income taxes included in the consolidated Statement of Operations for the year ended December 31, 2012 were as follows:

|                |    |           |
|----------------|----|-----------|
| Current:       |    |           |
| Federal        | \$ | 129,799   |
| State          |    | 30,264    |
| Total current  |    | 160,063   |
| Deferred:      |    |           |
| Federal        |    | (29,576 ) |
| State          |    | (4,918 )  |
| Total deferred |    | (34,494 ) |

|   |    |         |
|---|----|---------|
| Total income tax expense from operations continuing | \$ | 125,569 |
|---|----|---------|

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of the existing assets and liabilities and their respective tax basis.

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and liabilities as of December 31, 2012 were as follows:

|                                |  |         |
|--------------------------------|--|---------|
| Deferred tax liabilities:      |  |         |
| Unrealized gain on investments |  | 467,634 |
| Total deferred tax liabilities |  | 467,634 |

long-term capital gain balance of \$2,618,572 which the Trustees voted to retain and pay the Federal capital gain tax thereon. The Trust has incurred income tax expense of \$916,500 and \$296,098 respectively, on the Statement of Operations related to the 2012 and 2011 retained realized capital gains.

The Trust is taxed as a regulated investment company and is therefore limited as to the amount of non-qualified income that it may receive as the result of operating a trade or business, e.g. the Trust's pro rata share of income allocable to the Trust by a partnership operating company. The Trust's violation of this limitation could result in the loss of its status as a regulated investment company, thereby subjecting all of its net income and capital gains to corporate taxes prior to distribution to its shareholders. The Trust, from time-to-time, identifies investment opportunities in the securities of entities that could cause such trade or business income to be allocable to the Trust. The PI Subsidiary Trust (described in Footnote 1, above) was formed in order to allow investment in such securities without adversely affecting the Trust's status as a regulated investment company.

Net investment income and net realized gains or losses of the Trust as presented under U.S. GAAP may differ from distributable

Net deferred tax liability \$ (467,634 )

Beginning with the 2009 annual financial statements, the Trust recognizes a tax benefit from an uncertain position only if it is more likely than not that the position is sustainable, based solely on its technical merits and consideration of the relevant taxing authority's widely understood administrative practices and precedents. If this threshold is met, the Trust measures the tax benefit as the largest amount of benefit that is greater than

## 2012 Annual Report

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

fifty percent likely of being realized upon ultimate settlement. The Trust has evaluated and determined that the tax positions did not have a material effect on the Trust's financial position and results of operations for the year ended December 31, 2012.

A reconciliation of the differences between the PI Subsidiary Trust's income tax expense and the amount computed by applying the prevailing U.S. federal tax rate to pretax income for the year ended December 31, 2012 is as follows:

|   | Amount    | Percentage |    |
|---|-----------|------------|----|
| Provision for income taxes at the U.S. federal rate | 122,375   | 35.00      | %  |
| State tax, net of federal effect                    | 12,500    | 3.58       | %  |
| Change in valuation allowance                       | (28,513 ) | (8.15      | %) |
| Other   | 19,207    | 5.49       | %  |
| Income tax expense                                  | 125,569   | 35.91      | %  |

### Investment Advisory and Administrative Services

#### A. Services:

Under an Investment Advisory and Administrative Services Contract (the "Contract") with the Trust, Babson Capital has agreed to use its best efforts to present to the Trust a continuing and suitable investment program consistent with the investment objectives and policies of the Trust. Babson Capital represents the Trust in any negotiations with issuers, investment banking firms, securities brokers or dealers and other institutions or investors relating to the Trust's investments. Under the Contract, Babson Capital also provides administration of the day-to-day operations of the Trust and provides the Trust with office space and office equipment, accounting and bookkeeping services, and necessary executive, clerical and secretarial personnel for the performance of the foregoing services.

#### B. Fee:

For its services under the Contract, Babson Capital is paid a quarterly investment advisory fee equal to 0.225% of the value of the Trust's net assets as of the last business day of each fiscal quarter, an amount approximately equivalent to 0.90% on an annual basis. A majority of the Trustees, including a majority of the Trustees who are not interested persons of the Trust or of Babson Capital, approve the valuation of the Trust's net assets as of such day.

Each of the Trust's Federal tax returns for the prior three fiscal years remain subject to examination by the Internal Revenue Service.

#### E. Distributions to Shareholders:

The Trust records distributions to shareholders from net investment income and net realized gains, if any, on the ex-dividend date. The Trust's net investment income dividend is declared four times per year, in April, July, October, and December. The Trust's net realized capital gain distribution, if any, is declared in December.

The components capital shown in the following table represent the Trust's undistributed net investment income, undistributed net capital gains, losses the Trust may be able to offset against gains in future taxable years, as well as unrealized appreciation (depreciation) on securities and other fund investments, if any, at December 31, 2012, each of which determined on a U.S. federal tax basis:

| Undistributed<br>(Overdistributed)<br>Undistributed<br>Accumulated<br>Net<br>Investment<br>Income | Net Capital<br>Gain | Loss<br>Carryforward | Net<br>Unrealized<br>Appreciation<br>(Depreciation)<br>on Securities<br>and Other<br>Investments |
|---|---------------------|----------------------|--|
| \$ 1,484,941  | \$ 2,618,141        | \$ 0                 | \$ (3,449,918)   |

The tax character of distributions declared during the years ended December 31, 2012 and 2011 was as follows:

| Distributions paid from: | 2012 | 2011 |
|--------------------------|------|------|
|--------------------------|------|------|

|                         |               |               |
|-------------------------|---------------|---------------|
| Ordinary Income         | \$ 10,972,333 | \$ 12,412,703 |
| Long-term Capital Gains | \$ -          | \$ -          |

#### 4. Senior Secured Indebtedness

MassMutual holds the Trust's \$15,000,000 Senior Fixed Rate Convertible Note (the "Note") issued by the Trust on December 13, 2011. The Note is due December 13, 2023 and accrues interest at 4.09% per annum. MassMutual, at its option, can convert the principal amount of the Note into common shares. The dollar amount of principal would be converted into an equivalent dollar amount of common shares based upon the average price of the common shares for ten business days prior to the notice of conversion. For the year ended December 31, 2012, the Trust incurred total interest expense on the Note of \$613,500.

The Trust may redeem the Note, in whole or in part, at the principal amount proposed to be redeemed together with the accrued and unpaid interest thereon through the redemption date plus the Make Whole Premium. The Make Whole Premium equals the excess of (i) the present value of the scheduled payments of principal and interest which the Trust would have paid but for the proposed redemption, discounted at the rate of interest of U.S. Treasury obligations whose maturity approximates that of the Note plus 0.50% over (ii) the principal of the Note proposed to be redeemed.

Management estimates that the fair value of the Note was \$15,208,200 as of December 31, 2012



Babson Capital Participation Investors

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

5. Purchases and Sales of Investments

|                                 | For the year ended<br>12/31/2012           |                                    |
|---------------------------------|--|------------------------------------|
|                                 | Proceeds<br>from Sales<br>or<br>Maturities | Cost of<br>Investments<br>Acquired |
| Corporate restricted securities | \$43,442,960                               | \$34,491,127                       |
| Corporate public securities     | 931,260                                    | 9,576,793                          |

The aggregate cost of investments is substantially the same for financial reporting and Federal income tax purposes as of December 31, 2012. The net unrealized depreciation of investments for financial reporting and Federal tax purposes as of December 31, 2012 is \$6,686,070 and consists of \$13,512,675 appreciation and \$20,198,745 depreciation.

Net unrealized depreciation of investments on the Statement of Assets and Liabilities reflects the balance net of a deferred tax liability of \$467,634 on net unrealized gains on the PI Subsidiary Trust.

6. Quarterly Results of Investment Operations (Unaudited)

|                             | March 31, 2012 |           |
|-----------------------------|----------------|-----------|
|                             | Amount         | Per Share |
| Investment income           | \$3,397,647    |           |
| Net investment income       | 2,774,324      | \$0.27    |
| Net realized and unrealized |                |           |

7. Aggregate Remuneration Paid to Officers, Trustees, and their Affiliated Persons

For the year ended December 31, 2012, the Trust paid its Trustees aggregate remuneration of \$296,400. During the year, the Trust did not pay any compensation to any of its Trustees who are "interested persons" (as defined by the 1940 Act) of the Trust. The Trust classifies Messrs. Noreen and Joyal as "interested persons" of the Trust.

All of the Trust's officers are employees of Babson Capital or MassMutual. Pursuant to the Contract, the Trust does not compensate its officers who are employees of Babson Capital (except for the Chief Compliance Officer of the Trust unless assumed by Babson Capital). For the year ended December 31, 2012, Babson Capital paid the compensation of the Chief Compliance Officer of the Trust.

Mr. Noreen, one of the Trust's Trustees, is an "affiliated person" (as defined by the 1940 Act) of MassMutual and Babson Capital.

The Trust did not make any payments to Babson Capital for the year ended December 31, 2012, other than amounts payable to Babson Capital pursuant to the Contract.

8. Certifications

As required under New York Stock Exchange ("NYSE") Corporate Governance Rules, the Trust's principal executive officer has certified to the NYSE that he was not aware, as of the certification date, of any violation by the Trust of the NYSE's Corporate Governance listing standards. In addition, as required by Section 302 of the Sarbanes-Oxley Act of 2002 and related SEC rules, the Trust's principal executive and principal financial officers have made quarterly certifications, included in filings with the Securities and Exchange Commission on Forms N-CSR and N-Q, relating to, among other things, the Trust's disclosure controls and procedures and internal control over financial reporting, as applicable.

gain on  
investments  
(net of  
taxes) (223,921 ) (0.02 )

June 30, 2012  
Amount Per Share

Investment  
income \$3,181,794 9. Subsequent Events

Net  
investment  
income 2,521,978 \$0.25

Net realized  
and  
unrealized  
gain on  
investments  
(net of  
taxes) 1,102,771 0.11

The Trust has evaluated the possibility of subsequent events existing in this report through February 27, 2013. The Trust has determined that there are no material events that would require recognition or disclosure in this report through this date.

September 30, 2012  
Amount Per Share

Investment  
income \$3,204,878

Net  
investment  
income 2,533,303 \$0.25

Net realized  
and  
unrealized  
gain on  
investments  
(net of  
taxes) 3,574,928 0.35

December 31, 2012  
Amount Per Share

Investment  
income \$3,668,590

Net  
investment  
income 3,135,518 \$0.31

Net realized  
and  
unrealized  
gain on  
investments  
(net of  
taxes) 2,094,119 0.21





2012 Annual Report

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

KPMG LLP  
Two Financial center  
60 South Street Boston,  
MA 02111

The Shareholders and Board of Trustees of Babson Capital Participation Investors

We have audited the accompanying consolidated statement of assets and liabilities of Babson Capital Participation Investors (the "Trust"), including the consolidated schedule of investments, as of December 31, 2012, and the related consolidated statements of operations and cash flows for the year then ended, the consolidated statements of changes in net assets for each of the years in the two-year period then ended, and the consolidated selected financial highlights for each of the years in the five-year period then ended. These consolidated financial statements and consolidated selected financial highlights are the responsibility of the Trust's management. Our responsibility is to express an opinion on these consolidated financial statements and consolidated selected financial highlights based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements and consolidated selected financial highlights are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our procedures included confirmation of securities owned as of December 31, 2012 by correspondence with the custodian or by other appropriate auditing procedures. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements and consolidated selected financial highlights referred to above present fairly, in all material respects, the financial position of Babson Capital Participation Investors as of December 31, 2012, the results of their consolidated operations and cash flows for the year then ended, the consolidated changes in its net assets for each of the years in the two-year period then ended, and the consolidated selected financial highlights for each of the years in the five-year period then ended, in conformity with U.S. generally accepted accounting principles.

Boston, Massachusetts  
February 27, 2013



## Babson Capital Participation Investors

## INTERESTED TRUSTEES

| Name (Age),<br>Address   | Position<br>With<br>The Trust | Office<br>Team /<br>Length<br>of Time<br>Served      | Principal<br>Occupations<br>During Past 5 Years   | Portfolios<br>Overseen<br>in Fund<br>Complex | Other Directorships<br>Held by Director   |
|--|-------------------------------|--|---|--|---|
| Clifford M.<br>Noreen* (55)<br>Babson Capital<br>Participation<br>Investors<br>1500 Main<br>Street<br>P.O. Box 15189<br>Springfield,<br>MA<br>01115-5189 | Trustee<br>/<br>Chairman      | Term<br>expires<br>2015;<br>Trustee<br>since<br>2009 | President of Babson<br>Capital (since 2008),<br>Vice Chairman<br>(2007-2008),<br>Member of the Board<br>of Managers (since<br>2006), Managing<br>Director (since<br>2000), Babson<br>Capital; President<br>(2005-2009), Vice<br>President<br>(1993-2005) of the<br>Trust. | 2  | Chairman and Trustee (since 2009),<br>President (2005-2009), Vice President<br>(1993-2005), Babson Capital Corporate<br>Investors; President (since 2009), Senior<br>Vice President (1996-2009), HYP<br>Management LLC (LLC Manager);<br>Director (2005-2013), MassMutual<br>Corporate Value Limited (investment<br>company); Director (2005-2013),<br>MassMutual Corporate Value Partners<br>Limited (investment company); Senior<br>Vice President (1996-2008), MMHC<br>Investment LLC (passive investor);<br>Managing Director (2006-2009),<br>MassMutual Capital Partners LLC<br>(investment company); Director (since<br>2008), Jefferies Finance LLC (a finance<br>company); Chairman and Chief Executive<br>Officer (since 2009), Manager (since<br>2007), MMC Equipment Finance LLC;<br>Chairman (since 2009), Trustee (since<br>2005), President (2005-2009), CI<br>Subsidiary Trust and PI Subsidiary Trust;<br>and Member of Investment Committee<br>(since 1999), Diocese of Springfield. |

\*Mr. Noreen is classified as an “interested person” of the Trust and Babson Capital (as defined by the Investment Company Act of 1940, as amended) because of his position as an Officer of the Trust and President of Babson Capital.

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## 2012 Annual Report

## INTERESTED TRUSTEES

| Name (Age),<br>Address  | Position<br>With<br>The Trust | Office<br>Team /<br>Length<br>of Time<br>Served      | Principal<br>Occupations<br>During Past 5 Years   | Portfolios<br>Overseen<br>in Fund<br>Complex | Other Directorships<br>Held by Director  |
|---|-------------------------------|--|---|--|--|
| Robert E.<br>Joyal* (68)<br>Babson Capital<br>Participation<br>Investors<br>1500 Main<br>Street<br>P.O. Box 15189<br>Springfield,<br>MA<br>01115-5189 | Trustee /<br>Nominee          | Term<br>expires<br>2013;<br>Trustee<br>since<br>2003 | Retired (since 2003);<br>President<br>(2001-2003), Babson<br>Capital; and<br>President (1993 -<br>2003) of the Trust. | 97   | Trustee (since 2003), President<br>(1993-2003), Babson Capital Corporate<br>Investors; Director (since 2006), Jefferies<br>Group, Inc. (financial services); Director<br>(2003-2010), Alabama Aircraft Industries,<br>Inc. (aircraft maintenance and overhaul);<br>Director (2007-2011), Scottish Re Group<br>Ltd. (global life reinsurance specialist);<br>Director (2005-2006), York Enhanced<br>Strategy Fund (closed-end fund); Trustee<br>(since 2003), MassMutual Select Funds<br>(an open- end investment company<br>advised by MassMutual); Trustee (since<br>2003), MML Series Investment Fund (an<br>open-end investment company advised by<br>MassMutual); Trustee (since 2012),<br>MassMutual Series Investment Fund II (an<br>open-ended investment company advised<br>by MassMutual); Trustee (since 2012),<br>MassMutual Premier Funds (an<br>open-ended investment company advised<br>by MassMutual); and Director (since<br>2012), Ormat Technologies, Inc. (a<br>geothermal energy company). |

\*Mr. Joyal retired as President of Babson Capital in June 2003. In addition and as noted above, Mr. Joyal is a director of Jefferies Group, Inc., which has a wholly-owned broker-dealer subsidiary that may execute portfolio transactions and/or engage in principal transactions with the Trust, other investment companies advised by Babson Capital or any other advisory accounts over which Babson Capital has brokerage placement discretion. Accordingly, the Trust has determined to classify Mr. Joyal as an “interested person” of the Trust and Babson Capital (as defined by the Investment Company Act of 1940, as amended).

## Babson Capital Participation Investors

## INDEPENDENT TRUSTEES

| Name (Age),<br>Address   | Position<br>With<br>The Trust | Office<br>Team /<br>Length<br>of Time<br>Served   | Principal Occupations<br>During Past 5 Years   | Portfolios<br>Overseen<br>in Fund<br>Complex | Other Directorships<br>Held by Director  |
|--|-------------------------------|---|--|--|--|
| William J.<br>Barrett (73)<br>Babson Capital<br>Participation<br>Investors<br>1500 Main<br>Street<br>P.O. Box<br>15189<br>Springfield,<br>MA<br>01115-5189 | Trustee                       | Term<br>expires<br>2015;<br>Trustee<br>since<br>2006  | President (since 2010), WJ 2<br>Barrett Associates, Inc.;<br>President (2002 - 2010),<br>Barrett-Gardner Associates,<br>Inc. (private merchant<br>bank).   | 2  | Trustee (since 2006), Babson Capital<br>Corporate Investors; Director (since<br>1979), TGC Industries, Inc.<br>(geophysical services); Director and<br>Secretary (since 2001 and from<br>1996-1997), Chase Packaging<br>Corporation (agricultural services);<br>Chairman and Director (since 2000),<br>Rumson-Fair Haven Bank and Trust<br>Company (commercial bank and<br>trust company); and Director (since<br>1983), Executive Vice President.<br>Secretary and Assistant Treasurer<br>(since 2004), Supreme Industries,<br>Inc. (specialized truck and body<br>manufacturer). |
| Donald E.<br>Benson* (82)<br>Babson Capital<br>Participation<br>Investors<br>1500 Main<br>Street<br>P.O. Box<br>15189<br>Springfield,<br>MA<br>01115-5189  | Trustee                       | Term<br>expires<br>2013;<br>Trustee<br>since<br>1986 for<br>MCI and<br>since<br>1988 for<br>MPV | Executive Vice President<br>and Director (since 1992),<br>Marquette Financial<br>Companies (financial<br>services); and Partner (since<br>1996), Benson Family<br>Limited Partnership No. 1<br>and Benson Family Limited<br>Partnership No.2<br>(investment partnerships). | 2  | Trustee (since 1986), Babson Capital<br>Corporate Investors; Director<br>(1997-2008), MAIR Holdings, Inc.<br>(commuter airline holding<br>company); and Director (since<br>1997), First California Financial<br>Group, Inc. (bank holding<br>company).   |
| Michael H.<br>Brown (56)<br>Babson Capital   | Trustee                       | Term<br>expires<br>2014;<br>Trustee since   | Private Investor; and<br>Managing Director<br>(1994-2005), Morgan<br>Stanley.  | 2  | Trustee (since 2005), Babson Capital<br>Corporate Investors; Independent<br>Director (since 2006), derivative<br>trading company owned indirectly  |

Participation  
Investors  
1500 Main  
Street  
P.O. Box  
15189  
Springfield,  
MA  
01115-5189

2005

by MassMutual).

\* Due to the Trust's mandatory retirement policy, Mr. Benson's term will expire on April 19, 2013.

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## 2012 Annual Report

## INDEPENDENT TRUSTEES

| Name (Age),<br>Address   | Position<br>With<br>The Trust | Office Team /<br>Length<br>of Time<br>Served   | Principal<br>Occupations<br>During Past 5 Years  | Portfolios<br>Overseen<br>in Fund<br>Complex | Other Directorships<br>Held by Director   |
|--|-------------------------------|--|--|--|---|
| Donald<br>Glickman*^<br>(79)<br>Babson Capital<br>Participation<br>Investors<br>1500 Main<br>Street<br>P.O. Box<br>15189<br>Springfield,<br>MA<br>01115-5189 | Trustee                       | Term<br>expires 2013;<br>Trustee since<br>1992 | Chairman (since<br>1992), Donald<br>Glickman and<br>Company, Inc .<br>(private<br>investments); and<br>Partner (since 1992),<br>J.F. Lehman & Co.<br>(private<br>investments).   | 2  | Trustee (since 1992), Babson Capital<br>Corporate Investors; Director (since<br>1984), Monro Muffler and Brake, Inc.<br>(automobile repair service); and Lead<br>Director (1998-2009), MSC Software<br>Corp. (simulation software).   |
| Edward P.<br>Grace III (62)<br>Babson Capital<br>Participation<br>Investors<br>1500 Main<br>Street<br>P.O. Box<br>15189<br>Springfield,<br>MA<br>01115-5189  | Trustee /<br>Nominee          | Term expires<br>2013;<br>Trustee since<br>2012 | President (since<br>1997), Phelps Grace<br>International, Inc.<br>(investment<br>management);<br>Managing Director<br>(since 1998), Grace<br>Ventures Partners<br>LP (venture capital<br>fund); Senior<br>Advisor (since<br>2011), Angelo<br>Gordon & Co.<br>(investment adviser). | 2  | Trustee (since 2012), Babson Capital<br>Corporate Investors; Director (since<br>2010), Larkburger, Inc. (restaurant<br>chain); Director (since 2012),<br>Benihana, Inc. (restaurant chain);<br>Director (since 2011), Firebirds Wood<br>Fired Holding Corporation (restaurant<br>chain); Director (since 1998), Shawmut<br>Design and Construction (construction<br>management and general contracting<br>firm); Director (2004-2012), Not Your<br>Average Joe's, Inc. (restaurant chain);<br>Director (2008-2010), Logan's<br>Roadhouse, Inc. (restaurant); Director<br>(2007-2009), Claim Jumper Restaurants<br>(restaurant chain); Director<br>(1996-2008), RARE Hospitality<br>International, Inc. (restaurant chain);<br>Director (2006-2008), Quintess/Dream<br>Catchers Retreats; Director<br>(2004-2009), The Gemesis Corporation |

(cultivator of cultured diamonds);  
Trustee (1999- 2008), Bryant  
University; Trustee (1977-2010),  
Johnson & Wales University.

\*MassMutual and its affiliates are limited partners in three private investment funds in which affiliates of J.F. Lehman & Co. serve as the general partner and adviser and as such hold a carried interest. During the past two fiscal years, MassMutual and its affiliates have paid approximately \$339,812 in management fees to these J.F. Lehman affiliates attributable to the investments in the limited partnerships.

^ Due to the Trust's mandatory retirement policy, Mr. Glickman's term will expire on April 19, 2013.

## Babson Capital Participation Investors

## INDEPENDENT TRUSTEES

| Name (Age),<br>Address  | Position<br>With<br>The Trust | Office<br>Team /<br>Length<br>of Time<br>Served      | Principal<br>Occupations<br>During Past 5<br>Years   | Portfolios<br>Overseen<br>in Fund<br>Complex | Other Directorships<br>Held by Director   |
|---|-------------------------------|--|--|--|---|
| Martin T.<br>Hart* (77)<br>Babson<br>Capital<br>Participation<br>Investors<br>1500 Main<br>Street<br>P.O. Box<br>15189<br>Springfield,<br>MA<br>01115-5189  | Trustee                       | Term<br>expires<br>2015;<br>Trustee<br>since<br>1991 | Private Investor;<br>and President<br>and Director<br>(since 1983), H<br>Investment<br>Company LLC<br>(family<br>partnership).   | 2  | Trustee (since 1991), Babson Capital Corporate<br>Investors; Director (since 2004), Texas<br>Roadhouse, Inc. (operates restaurant chain); and<br>Director (since 1999), Value Click, Inc. (internet<br>advertising company).  |
| Susan B.<br>Sweeney (60)<br>Babson<br>Capital<br>Participation<br>Investors<br>1500 Main<br>Street<br>P.O. Box<br>15189<br>Springfield,<br>MA<br>01115-5189 | Trustee /<br>Nominee          | Term<br>expires<br>2013;<br>Trustee<br>since<br>2012 | Senior Vice<br>President and<br>Chief Investment<br>Officer (since<br>2010), Selective<br>Insurance<br>Company of<br>America; Senior<br>Managing<br>Director<br>(2008-2010),<br>Ironwood<br>Capital. | 93   | Trustee (since 2012), Babson Capital Corporate<br>Investors; Trustee (since 2009), MassMutual<br>Select Funds (an open-ended investment company<br>advised by MassMutual); Trustee (since 2009),<br>MML Series Investment Fund (an open-ended<br>investment company advised by MassMutual);<br>Trustee (since 2012), MassMutual Premier Funds<br>(an open-ended investment company advised by<br>MassMutual); Trustee (since 2012), MML Series<br>Investment Fund II (an open-ended investment<br>company advised by MassMutual). |

|   |                |  |   |  |
|---|----------------|--|---|--|
| <p>Maleyne M. Syracuse (56) Babson Capital Participation Investors 1500 Main Street P.O. Box 15189 Springfield, MA 01115-5189</p> | <p>Trustee</p> | <p>Term expires 2014; Trustee since 2007</p> | <p>Private Investor; 2 Managing Director (2000-2007), JP Morgan Securities, Inc . (investments and banking); Managing Director (1981 - 2000), Deutsche Bank Securities.</p> | <p>Trustee (since 2007), Babson Capital Corporate Investors.</p> |
|---|----------------|--|---|--|

\* Due to the Trust's mandatory retirement policy, Mr. Hart resigned as Trustee of Trust on December 14, 2012.

## 2012 Annual Report

## OFFICERS OF THE TRUST

| Name (Age),<br>Address   | Position<br>With<br>The Trust                          | Office<br>Team /<br>Length<br>of Time<br>Served | Principal Occupations<br>During Past 5 Years   |
|--|--|---|--|
| Michael L.<br>Klofas (52)<br>Babson Capital<br>Participation<br>Investors<br>1500 Main<br>Street<br>P.O. Box 15189<br>Springfield, MA<br>01115-5189        | President  | Since<br>2009                                   | Vice President (1998-2009), of the Trust; President (since 2009), Vice President (1998- 2009), Babson Capital Corporate Investors; Managing Director (since 2000), Babson Capital; and President (since 2009), Vice President (2005-2009), CI Subsidiary Trust and PI Subsidiary Trust.  |
| Christopher A.<br>DeFrancis (46)<br>Babson Capital<br>Participation<br>Investors<br>1500 Main<br>Street<br>P.O. Box 15189<br>Springfield, MA<br>01115-5189 | Vice<br>President<br>and<br>Secretary                  | Since<br>2010                                   | Associate Secretary (2008-2010), of the Trust; Vice President and Secretary (since 2010), Associate Secretary (2008-2010), Babson Capital Corporate Investors; Chief Compliance Officer (since 2011), Co-General Counsel, Secretary, and Managing Director (since 2010), Senior Counsel, Assistant Secretary and Managing Director (2010), Assistant Secretary and Counsel (2008-2009), Babson Capital; Counsel (2001-2009), Massachusetts Mutual Life Insurance Company; Vice President and Secretary (since 2010), Assistant Secretary (2009-2010), CI Subsidiary Trust and PI Subsidiary Trust. |
| James M. Roy<br>(50)<br>Babson Capital<br>Participation<br>Investors<br>1500 Main<br>Street<br>P.O. Box 15189<br>Springfield, MA<br>01115-5189             | Vice<br>President<br>and Chief<br>Financial<br>Officer | Since<br>2005                                   | Treasurer (2003-2005), Associate Treasurer (1999-2003) of the Trust; Vice President and Chief Financial Officer (since 2005), Treasurer (2003-2005), Associate Treasurer (1999-2003), Babson Capital Corporate Investors; Managing Director (since 2005), Director (2000-2005), Babson Capital; and Trustee (since 2005), Treasurer (since 2005), Controller (2003-2005), CI Subsidiary Trust and PI Subsidiary Trust.   |

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|   |                                   |   |
|---|-----------------------------------|---|
| <p>John T. Davitt, Jr. (45)<br/>Babson Capital Participation Investors<br/>1500 Main Street<br/>P.O. Box 15189<br/>Springfield, MA<br/>01115-5189</p> | <p>Comptroller Since<br/>2001</p> | <p>Comptroller (since 2001), Babson Capital Corporate Investors; Director (since 2000), Babson Capital; and Controller (since 2005), CI Subsidiary Trust and PI Subsidiary Trust.</p> |
|---|-----------------------------------|---|

|  |  |  |
|--|--|--|
| <p>Melissa M. LaGrant (39)<br/>Babson Capital Participation Investors<br/>1500 Main Street<br/>P.O. Box 15189<br/>Springfield, MA<br/>01115-5189</p> | <p>Chief Compliance Officer Since<br/>2006</p> | <p>Chief Compliance Officer (since 2006), Babson Capital Corporate Investors; Chief Compliance Officer (since 2012) Babson Capital Global Short Duration High Yield Fund; Managing Director (since 2005), Babson Capital; Vice President and Senior Compliance Trading Manager (2003-2005), Loomis, Sayles &amp; Company, L.P.; and Assistant Vice President-Business Risk Management Group (2002-2003), Assistant Vice President-Investment Compliance (2001-2002), Zurich Scudder Investments/Deutsche Asset Management.</p> |
|--|--|--|

|  |                                 |   |
|--|---------------------------------|---|
| <p>Daniel J. Florence (40)<br/>Babson Capital Participation Investors<br/>1500 Main Street<br/>P.O. Box 15189<br/>Springfield, MA<br/>01115-5189</p> | <p>Treasurer Since<br/>2008</p> | <p>Associate Treasurer (2006-2008) of the Trust; Treasurer (since 2008), Associate Treasurer (2006-2008), Babson Capital Corporate Investors; and Associate Director (since 2008), Analyst (2000-2008), Babson Capital.</p> |
|--|---------------------------------|---|

\*Officers hold their position with the Trust until a successor has been duly elected and qualified. Officers are generally elected annually by the Board of Trustees of the Trust. The officers were last elected on July 18, 2012.

## Babson Capital Participation Investors

## OFFICERS OF THE TRUST

| Name (Age),<br>Address   | Position<br>With<br>The Trust | Office<br>Team /<br>Length<br>of Time<br>Served | Principal Occupations<br>During Past 5 Years   |
|--|-------------------------------|---|--|
| Sean Feeley<br>(45)<br>Babson Capital<br>Participation<br>Investors<br>1500 Main<br>Street<br>P.O. Box 15189<br>Springfield, MA<br>01115-5189        | Vice<br>President             | Since<br>2011                                   | Vice President (since 2011), Babson Capital Corporate Investors; Vice President (since 2012), Babson Capital Global Short Duration High Yield Fund; Managing Director (since 2003), Babson Capital; and Vice President (since 2011), CI Subsidiary Trust and PI Subsidiary Trust.  |
| Michael P.<br>Hermsen (52)<br>Babson Capital<br>Participation<br>Investors<br>1500 Main<br>Street<br>P.O. Box 15189<br>Springfield, MA<br>01115-5189 | Vice<br>President             | Since<br>1998                                   | Since 1998 Vice President (since 1998), Babson Capital Corporate Investors; Managing Director (since 2000), Babson Capital; Vice President (since 2005), CI Subsidiary Trust and PI Subsidiary Trust; Director (since 2009), Babson Capital Asia Limited; and Director (since 2009), Babson Capital Australia Holding Company Pty. Ltd. and Babson Capital Australia Pty. Ltd. |
| Mary Wilson<br>Kibbe (59)<br>Babson Capital<br>Participation<br>Investors<br>1500 Main<br>Street<br>P.O. Box 15189<br>Springfield, MA<br>01115-5189  | Vice<br>President             | Since<br>1992                                   | Since 1992 Vice President (since 1992), Babson Capital Corporate Investors; Head of Fixed Income Team (since 2000), Managing Director (since 2000), Babson Capital.  |

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| Richard E. Spencer, II (50) | Vice President | Since 2002 | Since 2002 Vice President (since 1992), Babson Capital Corporate Investors; Managing Director (since 2000), Babson Capital; and Vice President (since 2005), CI Subsidiary Trust and PI Subsidiary Trust. |
|-----------------------------|----------------|------------|---|
|-----------------------------|----------------|------------|---|

Babson Capital Participation Investors  
1500 Main Street  
P.O. Box 15189  
Springfield, MA  
01115-5189

\*Officers hold their position with the Trust until a successor has been duly elected and qualified. Officers are generally elected annually by the Board of Trustees of the Trust. The officers were last elected on July 18, 2012.



2012 Annual Report

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Members of the Board of Trustees

DIVIDEND REINVESTMENT AND SHARE PURCHASE PLAN

|   |  |
|---|--|
| <p>William J. Barrett<br/>President,<br/>W J Barrett Associates, Inc.</p>                             | <p>Babson Capital Participation Investors (the “Trust”) offers a Dividend Reinvestment and Cash Purchase Plan (the “Plan”). The Plan provides a simple and automatic way for shareholders to add to their holdings in the Trust through the receipt of dividend shares issued by the Trust or through the reinvestment of cash dividends in Trust shares purchased in the open market. The dividends of each shareholder will be automatically reinvested in the Trust by DST Systems, Inc., the Transfer Agent, in accordance with the Plan, unless such shareholder elects not to participate by providing written notice to the Transfer Agent. A shareholder may terminate his or her participation by notifying the Transfer Agent in writing.</p>  |
| <p>Donald E. Benson*<br/>Executive Vice President and Director,<br/>Marquette Financial Companies</p> | <p>Participating shareholders may also make additional contributions to the Plan from their own funds. Such contributions may be made by personal check or other means in an amount not less than \$100 nor more than \$5,000 per quarter. Cash contributions must be received by the Transfer Agent at least five days (but no more than 30 days) before the payment date of a dividend or distribution.</p>  |
| <p>Michael H. Brown*<br/>Private Investor</p>   | <p>Whenever the Trust declares a dividend payable in cash or shares, the Transfer Agent, acting on behalf of each participating shareholder, will take the dividend in shares only if the net asset value is lower than the market price plus an estimated brokerage commission as of the close of business on the valuation day. The valuation day is the last day preceding the day of dividend payment. When the dividend is to be taken in shares, the number of shares to be received is determined by dividing the cash dividend by the net asset value as of the close of business on the valuation date or, if greater than net asset value, 95% of the closing share price. If the net asset value of the shares is higher than the market value plus an estimated commission, the Transfer Agent, consistent with obtaining the best price and execution, will buy shares on the open market at current prices promptly after the dividend payment date.</p> |

The reinvestment of dividends does not, in any way, relieve participating shareholders of any federal, state or local tax. For federal income tax purposes, the amount reportable in respect of a dividend received in newly-issued shares of the Trust will be the fair market value of the shares received, which will be reportable as ordinary income and/ or capital gains.

As compensation for its services, the Transfer Agent receives a fee of 5% of any dividend and cash contribution (in no event in excess of \$2.50 per distribution per shareholder.)

Any questions regarding the Plan should be addressed to DST Systems, Inc., Agent for Babson Capital Participation Investors’ Dividend Reinvestment and Cash Purchase Plan, P.O. Box 219086, Kansas City, MO 64121-9086.

Officers

Donald  
Glickman  
Chairman,  
Donald  
Glickman  
& Company,  
Inc.

|   |   |   |   |   |
|---|---|---|---|---|
| Edward P.<br>Grace<br>President<br>Phelps Grace<br>International,<br>Inc. | Clifford M. Noreen<br>Chairman<br><br>Sean Feeley<br><br>Vice President<br>John T. Davitt, Jr.<br>Comptroller | Michael L. Klofas<br>President<br><br>Michael P. Hermsen<br><br>Vice President<br>Melissa M. LaGrant<br>Chief Compliance<br>Officer | James M. Roy<br>Vice President and<br>Chief Financial<br>Officer<br>Richard E. Spencer,<br>II<br>Vice President | Christopher A.<br>DeFrancis<br>Vice President and<br>Secretary<br>Daniel J. Florence<br><br>Treasurer |
|---|---|---|---|---|

Martin T.  
Hart  
Private  
Investor

Robert E.  
Joyal  
Retired  
President,  
Babson  
Capital  
Management  
LLC

Clifford M.  
Noreen  
President,  
Babson  
Capital  
Management  
LLC

Susan B.  
Sweeney  
Senior Vice  
President and

Chief  
Investment  
Officer  
Selective  
Insurance  
Company of  
America

Maleyne M.  
Syracuse\*  
Private  
Investor

\*Member of the Audit Committee



## ITEM 2. CODE OF ETHICS.

The Registrant adopted a Code of Ethics for Senior Financial Officers (the "Code") on October 17, 2003, which is available on the Registrant's website at [www.babsoncapital.com/mpv](http://www.babsoncapital.com/mpv). During the period covered by this Form N-CSR, there were no amendments to, or waivers from, the Code.

## ITEM 3. AUDIT COMMITTEE FINANCIAL EXPERT.

The Registrant's Board of Trustees has determined that Mr. Donald E. Benson, a Trustee of the Registrant and a member of its Audit Committee, is an audit committee financial expert. Mr. Benson is "independent" for purposes of this Item 3 as required by applicable regulation.

## ITEM 4. PRINCIPAL ACCOUNTANT FEES AND SERVICES.

## Fees Billed to the Registrant

|                    | KPMG LLP<br>Year Ended<br>December 31,<br>2012 | KPMG LLP<br>Year Ended<br>December 31,<br>2011 |
|--------------------|--|--|
| Audit Fees         | \$ 61,500                                      | \$ 61,500                                      |
| Audit-Related Fees | 0  | 0  |
| Tax Fees           | 44,100   | 32,235   |
| All Other Fees     | 0  | 0  |
| Total Fees         | \$ 105,600                                     | \$ 93,735                                      |

## Non-Audit Fees Billed to Babson Capital and MassMutual

|                    | KPMG LLP<br>Year Ended<br>December 31,<br>2012 | KPMG LLP<br>Year Ended<br>December 31,<br>2011 |
|--------------------|--|--|
| Audit-Related Fees | \$ 685,475                                     | \$ 928,575                                     |
| Tax Fees           | 93,100   | 9,000  |
| All Other Fees     | 0  | 0  |
| Total Fees         | \$ 778,575                                     | \$ 937,575                                     |

The category "Audit-Related Fees" reflects fees billed by KPMG for various non-audit and non-tax services rendered to the Registrant, Babson Capital Management LLC ("Babson Capital"), and Massachusetts Mutual Life Insurance Company ("MassMutual"), such as SAS 70 review, IFRS consulting and agreed upon procedures reports. Preparation of Federal, state and local income tax returns and tax compliance work are representative of the fees reported in the "Tax Fees" category. The category "All Other Fees" represents fees billed by KPMG for consulting rendered to Babson Capital and MassMutual. The Sarbanes-Oxley Act of 2002 and its implementing regulations allows the Registrant's Audit Committee to establish a pre-approval policy for certain services rendered by the Registrant's independent accountants. During 2012, the Registrant's Audit Committee approved all of the services rendered to the Registrant by KPMG and did not rely on such a pre-approval policy for any such services.

The Audit Committee has also reviewed the aggregate fees billed for professional services rendered by KPMG for 2011 and 2012 for the Registrant and for the non-audit services provided to Babson Capital, and Babson Capital's parent, MassMutual. As part of this review, the Audit Committee considered whether the provision of such non-audit services was compatible with maintaining the principal accountant's independence.

The 2011 fees billed represent final 2011 amounts, which may differ from the preliminary figures available as of the filing date of the Registrant's 2012 Annual Form N-CSR and includes, among other things, fees for services that may not have been billed as of the filing date of the Registrant's 2012 Annual Form N-CSR, but are now properly included in the 2011 fees billed to the Registrant, Babson Capital and MassMutual.

#### ITEM 5. AUDIT COMMITTEE OF LISTED REGISTRANTS.

The Registrant maintains an Audit Committee composed exclusively of Trustees of the Registrant who qualify as "independent" Trustees under the current listing standards of the New York Stock Exchange and the rules of the U.S. Securities and Exchange Commission. The Audit Committee operates pursuant to a written Audit Committee Charter, which is available (1) on the Registrant's website, [www.babsoncapital.com/mpv](http://www.babsoncapital.com/mpv); and (2) without charge, upon request, by calling, toll-free 866-399-1516. The current members of the Audit Committee are Donald E. Benson, Michael H. Brown and Maleyne M. Syracuse.

#### ITEM 6. SCHEDULE OF INVESTMENTS

A schedule of investments for the Registrant is included as part of this report to shareholders under Item 1 of this Form N-CSR.

#### ITEM 7. DISCLOSURE OF PROXY VOTING POLICIES AND PROCEDURES FOR CLOSED-END MANAGEMENT INVESTMENT COMPANIES.

##### Summary of Babson Capital's Proxy Voting Policy:

Babson Capital views the voting of proxies as an integral part of its investment management responsibility and believes, as a general principle, that proxies should be acted upon (voted or abstained) solely in the best interest of its clients (i.e. in a manner it believes is most likely to enhance the economic value of the underlying securities held in client accounts). To implement this general principle, Babson Capital engages a proxy service provider (the "Service Provider") that is responsible for processing and maintaining records of proxy votes. In addition, the Service Provider will retain the services of an independent third party research provider (the "Research Provider") to provide research and recommendations on proxies. Babson Capital's Proxy Voting Policy is generally to vote proxies in accordance with the recommendations of the Research Provider. In circumstances where the Research Provider has not provided recommendations with respect to a proxy, Babson Capital will vote in accordance with the Research Provider's proxy voting guidelines (the "Guidelines"). In circumstances where the Research Provider has not provided a recommendation or has not contemplated an issue within its Guidelines, the proxy will be analyzed on a case-by-case basis.

Babson Capital recognizes that there may be times when it is in the best interest of clients to vote proxies (i) against the Research Provider's recommendations or (ii) in instances where the Research Provider has not provided a recommendation vote against the Guidelines. Babson Capital can vote, in whole or in part, against the Research Provider's recommendations or Guidelines, as it deems appropriate. The procedures set forth in the Proxy Voting Policy are designed to ensure that votes against the Research Provider's recommendations or Guidelines are made in the best interests of clients and are not the result of any material conflict of interest (a "Material Conflict"). For

purposes of the Proxy Voting Policy, a Material Conflict is defined as any position, relationship or interest, financial or otherwise, of Babson Capital or a Babson Capital associate that could reasonably be expected to affect the independence or judgment concerning proxy voting.

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Summary of Babson Capital's Proxy Voting Procedures:

Babson Capital will vote all client proxies for which it has proxy voting discretion, where no Material Conflict exists, in accordance with the Research Provider's recommendations or Guidelines, unless (i) Babson Capital is unable or determines not to vote a proxy in accordance with the Proxy Voting Policy or (ii) an authorized investment person or designee (a "Proxy Analyst") determines that it is in the client's best interests to vote against the Research Provider's recommendations or Guidelines. In such cases where a Proxy Analyst believes a proxy should be voted against the Research Provider's recommendations or Guidelines, the Proxy Administrator will vote the proxy in accordance with the Proxy Analyst's recommendation as long as (i) no other Proxy Analyst disagrees with such recommendation and (ii) no known Material Conflict is identified by the Proxy Analyst(s) or the Proxy Administrator. If a Material Conflict is identified by a Proxy Analysis or the Proxy Administrator, the proxy will be submitted to the Trading Practices Committee to determine how the proxy is to be voted in order to achieve that client's best interests.

No associate, officer, director or board of managers/directors of Babson Capital or its affiliates (other than those assigned such responsibilities under the Proxy Voting Policy) can influence how Babson Capital votes client proxies, unless such person has been requested to provide assistance by a Proxy Analyst or Trading Practices Committee member and has disclosed any known Material Conflict. Pre-vote communications are prohibited. In the event that pre-vote communications occur, it should be reported to the Trading Practices Committee or Babson Capital's Chief Compliance Officer or General Counsel prior to voting. Any questions or concerns regarding proxy-solicitor arrangements should be addressed to Babson Capital's Chief Compliance Officer and/or General Counsel.

Investment management agreements generally delegate the authority to vote proxies to Babson Capital in accordance with Babson Capital's Proxy Voting Policy. In the event an investment management agreement is silent on proxy voting, Babson Capital should obtain written instructions from the client as to their voting preference. However, when the client does not provide written instructions as to their voting preferences, Babson Capital will assume proxy voting responsibilities. In the event that a client makes a written request regarding voting, Babson Capital will vote as instructed.

Obtaining a Copy of the Proxy Voting Policy:

Clients may obtain a copy of Babson Capital's Proxy Voting Policy and information about how Babson Capital voted proxies related to their securities, free of charge, by contacting the Chief Compliance Officer, Babson Capital Management LLC, 1500 Main Street, Suite 2800, P.O. Box 15189, Springfield, MA 01115-5189, or calling toll-free, 1-877-766-0014.

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ITEM 8. PORTFOLIO MANAGERS OF CLOSED-END MANAGEMENT INVESTMENT COMPANIES.

The following disclosure item is made as of the date of this Form N-CSR unless otherwise indicated.

**PORTFOLIO MANAGER.** Michael L. Klofas serves as the President of the Registrant (since 2009) and as one of its Portfolio Managers. Mr. Klofas began his service to the Registrant in 1998 as a Vice President. With over 25 years of industry experience, Mr. Klofas is a Managing Director of the Mezzanine and Private Equity Group of Babson Capital Management LLC ("Babson Capital"). Mr. Klofas joined MassMutual in 1988. Prior to joining MassMutual, he spent two years at a small venture capital firm and two years at a national public accounting firm. At MassMutual and then Babson Capital, Mr. Klofas has analyzed and invested in traditional private placements and high yield public bonds. He also spent four years leading Babson Capital's workout and restructuring activities. Since 1993, he has focused on originating, analyzing, structuring and documenting mezzanine and private equity investments. Mr. Klofas holds a B.A. from Brandeis University and an M.B.A. from Babson College as well as a Certified Public Accountant designation. Mr. Klofas also presently serves as President of MassMutual Participation Investors, another closed-end management investment company advised by Babson Capital.

**PORTFOLIO MANAGEMENT TEAM.** Mr. Klofas has primary responsibility for overseeing the investment of the Registrant's portfolio, with the day-to-day investment management responsibility of the Registrant's portfolio being shared with the following Babson Capital investment professionals (together with the Portfolio Manager, the "Portfolio Team").

Michael P. Hermsen is a Vice President of the Registrant and a Managing Director of Babson Capital who oversees the Global Private Finance Group and manages Babson Capital's Mezzanine Investment and Private Equity Investments Team which is responsible for finding, analyzing, negotiating and servicing mezzanine private placement securities for the Registrant.

Mr. Hermsen joined MassMutual in 1990 and has been an officer of the Registrant since 1998. Previously, he worked at Teachers Insurance and Annuity Association where he was a generalist private placement analyst. At MassMutual and then Babson Capital, Mr. Hermsen has analyzed and invested in traditional private placements, high yield public and private bonds, and leveraged bank loans. He has also been responsible for managing a small portfolio of distressed investments. Since 1993, he has focused on originating, analyzing, structuring and documenting mezzanine and private equity investments. He holds a B.A. from Bowdoin College and an M.B.A. from Columbia University.

Mr. Spencer is a Vice President of the Registrant and a Managing Director of Babson Capital who also manages Babson Capital's Finance and Portfolio Analytics Group. Mr. Spencer joined MassMutual in 1989 after three years as a corporate loan analyst at a major New England bank. He has been an officer of the Registrant since 2002. At MassMutual and then Babson Capital, Mr. Spencer has analyzed and invested in traditional private placements, high yield public and private bonds, leveraged bank loans, mezzanine debt and private equity. From 1993 to 1999, he was the lead restructuring professional at Babson Capital. Since 1999, Mr. Spencer has been focused on the origination, analysis, structuring and documentation of mezzanine and private equity investments. He holds a B.A. from Bucknell University and an M.B.A. from the State University of New York at Buffalo.

Sean Feeley is responsible for the day-to-day management of the Registrant's public high yield and investment grade fixed income portfolio. Mr. Feeley has been a Vice President of the Registrant since 2011. Mr. Feeley is a Managing Director of Babson Capital and head of the High Yield Research Team with over 22 years of industry experience in high yield bonds and loans in various investment strategies. Prior to joining Babson Capital in 2003, he was a Vice President at Cigna Investment Management in project finance and a Vice President at Credit Suisse in leveraged loan finance. Mr. Feeley holds a B.S. from Canisius College and an M.B.A. from Cornell University. Mr. Feeley is a Certified Public Accountant and a Chartered Financial Analyst.

OTHER ACCOUNTS MANAGED BY THE PORTFOLIO TEAM. The members of the Registrant's portfolio Team also have primary responsibility for the day-to-day management of other Babson Capital advisory accounts, including, among others, closed-end and open-end investment companies, private investment funds, MassMutual-affiliated accounts, as well as separate accounts for institutional clients. These advisory accounts are identified below.

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| PORTFOLIO TEAM         | ACCOUNT CATEGORY                     | TOTAL NUMBER OF ACCOUNTS | NUMBER OF ACCOUNTS WITH APPROXIMATE TOTAL ASSET SIZE (A) | APPROXIMATE ASSET SIZE OF PERFORMANCE-BASED ADVISORY FEE | PERFORMANCE-BASED ADVISORY FEE ACCOUNTS (A) |
|------------------------|--------------------------------------|--------------------------|--|--|---|
| Clifford M. Noreen (B) | Registered Investment Companies      | 1                        | \$257.4 million  | 0  | N/A   |
|                        | Other Pooled Investment Vehicles     | 6                        | \$123.9 million  | 6  | \$123.9 million                             |
|                        | Other Accounts                       | 0                        | N/A  | 0  | N/A   |
| Sean Feeley            | Registered Investment Companies      | 4                        | \$1.1 billion  | 0  | N/A   |
|                        | Other Pooled Investment Vehicles     | 3                        | \$1.9 billion  | 3  | \$1.9 billion                               |
|                        | Other Accounts (C)                   | 2                        | \$127.9 million  | 2  | \$127.9 million                             |
| Michael P. Hermsen (D) | Registered Investment Companies      | 1                        | \$257.4 million  | 0  | N/A   |
|                        | Other Pooled Investment Vehicles (E) | 6                        | \$1.4 billion  | 6  | \$1.4 billion                               |
|                        | Other Accounts                       | 0                        | N/A  | 0  | N/A   |

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|                        |                                      |   |                 |   |     |
|------------------------|--------------------------------------|---|-----------------|---|-----|
| Michael L. Klofas      | Registered Investment Companies      | 1 | \$257.4 million | 0 | N/A |
|                        | Other Pooled Investment Vehicles (E) | 0 | N/A             | 0 | N/A |
|                        | Other Accounts                       | 0 | N/A             | 0 | N/A |
| Richard E. Spencer, II | Registered Investment Companies      | 1 | \$257.4 million | 0 | N/A |
|                        | Other Pooled Investment Vehicles (E) | 0 | N/A             | 0 | N/A |
|                        | Other Accounts                       | 0 | N/A             | 0 | N/A |

(A) Account asset size has been calculated as of December 31, 2012.

(B) Mr. Noreen, as head of Babson Capital's Fixed Income Group, has overall responsibility for all investment grade publicly traded assets, including corporate debt securities, as well as structured credit products managed by Babson Capital. Except for the accounts noted in the table above, Mr. Noreen is not primarily responsible for the day-to-day management of the other accounts managed by Babson Capital's Fixed Income Group.

(C) Mr. Feeley manages the high yield sector of the general investment account of Massachusetts Mutual Life Insurance Company and C.M. Life Insurance Company; however, these assets are not represented in the table above.

(D) Mr. Hermsen, as head of Babson Capital's Global Private Finance Group, has overall responsible for private bonds, mezzanine and private equity investments.

(E) Messrs. Hermsen, Klofas and Spencer manage private placement mezzanine debt securities for the general investment account of Massachusetts Mutual Life Insurance Company and C.M. Life Insurance Company; however these assets are not represented in the table above.

**MATERIAL CONFLICTS OF INTEREST.** The potential for material conflicts of interest may exist as the members of the Portfolio Management Team, have responsibilities for the day-to-day management of multiple advisory accounts. These conflicts may be heightened to the extent the individual, Babson Capital and/or an affiliate has an investment in one or more of such accounts. Babson Capital has identified (and summarized below) areas where material conflicts of interest are most likely to arise, and has adopted policies and procedures that it believes are reasonable designed to address such conflicts.

**Transactions with Affiliates:** Babson Capital or its affiliates, including MassMutual and its affiliates, may from time to time, acting as principal, buy securities or other investments for itself from or sell securities or other investments it owns to its advisory clients. Likewise, Babson Capital may either directly or on behalf of MassMutual, purchase and/or hold securities or other investments that are subsequently sold or transferred to advisory clients. Babson Capital has a conflict of interest in connection with a transaction where it or an affiliate is acting as principal since it may have an incentive to favor itself or its affiliates over its advisory clients in connection with the transaction. To address these conflicts of interest, Babson Capital has adopted a Transactions with Affiliates Policy, which ensures any such transaction is consistent with Babson Capital's fiduciary obligations to act in the best interests of its clients, including its ability to obtain best execution in connection with the transaction, and is in compliance with applicable legal and regulatory requirements.

**Cross Trades:** Babson Capital may effect cross-trades on behalf of its advisory clients whereby one advisory client buys securities or other investments from or sells securities or other investments to another advisory client. Babson Capital may also effect cross-transactions involving advisory accounts or funds in which it or its affiliates, including MassMutual, and their respective employees, have an ownership interest or for which Babson Capital is entitled to earn a performance or incentive fee. As a result, Babson Capital has a conflict of interest in connection with the cross-transaction since it may have an incentive to favor the advisory client or fund in which it or its affiliate has an ownership interest and/or is entitled to a performance or incentive fee. To address these conflicts of interest, Babson Capital has adopted a Transactions with Affiliates Policy, which ensures any such cross-transaction is consistent with Babson Capital's fiduciary obligations to act in the best interests of each of its advisory clients, including its ability to obtain best execution for each advisory client in connection with the cross-trade transaction, and is in compliance with applicable legal and regulatory requirements. Babson Capital will not receive a commission or any other remuneration (other than its advisory fee) for effecting cross-transactions between advisory clients.

**Loan Origination Transactions:** While Babson Capital or its affiliates generally do not act as an underwriter or member of a syndicate in connection with a securities offering, Babson Capital or its affiliates (or an unaffiliated entity in which Babson Capital or its affiliates has an ownership interest) may act as an underwriter, originator, agent, or member of a syndicate in connection with the origination of senior secured loans or other lending arrangements with borrowers, where such loans may be purchased by Babson Capital advisory clients during or after the original syndication. Babson Capital advisory clients may purchase such loans directly from Babson Capital or its affiliates (or an unaffiliated entity in which Babson Capital or its affiliates has an ownership interest) or from other members of the lending syndicate. Babson Capital or its affiliates may directly or indirectly receive underwriting, origination, or agent fees in connection with such loan originations. As a result, Babson Capital has a conflict of interest in connection with such loan origination transactions since it has an incentive to base its investment recommendation to its advisory clients on the amount of compensation, underwriting, origination or agent fees it would receive rather than on its advisory clients' best interests. To address this conflict of interest, Babson Capital has adopted a Transactions with Affiliates Policy, which ensures any such transaction is consistent with Babson Capital's fiduciary obligations to act in the best interests of its clients, including its ability to obtain best execution in connection with the transaction, and is in compliance with applicable legal and regulatory requirements.

MML Investors Services, LLC (“MMLISI”), an indirect wholly-owned subsidiary of MassMutual, is an SEC-registered broker-dealer that may act as an introducing broker for the purpose of effecting securities transactions for brokerage customers. While a Babson Capital advisory client could request that MMLISI effect securities transactions for it that would result in commissions to MMLISI, currently no Babson Capital advisory client directs Babson Capital to effect securities transactions for its account through MMLISI.

Investments by Advisory Clients: Babson Capital may invest client assets in securities or other investments that are also held by (i) Babson Capital or its affiliates, including MassMutual, (ii) other Babson Capital advisory accounts, (iii) funds or accounts in which Babson Capital or its affiliates or their respective employees have an ownership or economic interest or (iv) employees of Babson Capital or its affiliates. Babson Capital may also, on behalf of its advisory clients, invest in the same or different securities or instruments of issuers in which (i) Babson Capital or its affiliates, including MassMutual, (ii) other Babson Capital advisory accounts, (iii) funds or accounts in which Babson Capital, its affiliates, or their respective employees have an ownership or economic interest or (iv) employees of Babson Capital or its affiliates, have an ownership interest as a holder of the debt, equity or other instruments of the issuer. Babson Capital has a conflict of interest in connection with any such transaction since investments by its advisory clients may directly or indirectly benefit Babson Capital and/or its affiliates and employees by potentially increasing the value of the securities or instruments it holds in the issuer. Any investment by Babson Capital on behalf of its advisory clients will be consistent with its fiduciary obligations to act in the best interests of its advisory clients, and otherwise be consistent with such clients’ investment objectives and restrictions.

Babson Capital or its affiliates may also recommend that clients invest in registered or unregistered investment companies, including private investment funds such as hedge funds, private equity funds or structured funds (i) advised by Babson Capital or an affiliate, (ii) in which Babson Capital, an affiliate or their respective employees has an ownership or economic interest or (iii) with respect to which Babson Capital or an affiliate has an interest in the entity entitled to receive the fees paid by such funds. Babson Capital has a conflict of interest in connection with any such recommendation since it may have an incentive to base its recommendation to invest in such investment companies or private funds on the fees that Babson Capital or its affiliates would earn as a result of the investment by its advisory clients in the investment companies or private funds. Any recommendation to invest in a Babson Capital advised fund or other investment company will be consistent with Babson Capital’s fiduciary obligations to act in the best interests of its advisory clients, consistent with such clients’ investment objectives and restrictions. Babson Capital may, in certain limited circumstances, offer to clients that invest in private investment funds that it advises an equity interest in entities that receive advisory fees and carried profits interest from such funds.

Employee Co-Investment: Babson Capital may permit certain of its portfolio managers and other employees to invest in private investment funds advised by Babson Capital or its affiliates and/or share in the performance or incentive fees received by Babson Capital from such funds. If the portfolio manager or other employee was responsible for both the portfolio management of the private fund and other Babson Capital advisory accounts, such person would have a conflict of interest in connection with investment decisions since the person may have an incentive to direct the best investment ideas, or to allocate trades, in favor of the fund in which he or she is invested or otherwise entitled to share in the performance or incentive fees received from such fund. To address these conflicts of interest, Babson Capital has adopted a Side by Side Management of Private Investment Funds and Other Advisory Accounts Policy which requires, among others things, that Babson Capital treat each of its advisory clients in a manner consistent with its fiduciary obligations and prohibits Babson Capital from favoring any particular advisory account as a result of the ownership or economic interests of Babson Capital, its affiliates or employees, in such advisory account. Any investment by a Babson Capital employee in one of its private funds is also governed by Babson Capital’s Employee Co-Investment Policy, which ensures that any co-investment by a Babson Capital employee is consistent with Babson Capital’s Code of Ethics.

Management of Multiple Accounts: As noted above, Babson Capital’s portfolio managers are often responsible for the day-to-day management of multiple accounts, including, among others, separate accounts for institutional clients,

closed-end and open-end registered investment companies, and/or private investment funds (such as hedge funds, private equity funds and structured funds), as well as for proprietary accounts of Babson Capital and its affiliates, including MassMutual and its affiliates. The potential for material conflicts of interest exist whenever a portfolio manager has responsibility for the day-to-day management of multiple advisory accounts. These conflicts may be heightened to the extent a portfolio manager is responsible for managing a proprietary account for Babson Capital or its affiliates or where the portfolio manager, Babson Capital and/or an affiliate has an investment in one or more of such accounts or an interest in the performance of one or more of such accounts (e.g., through the receipt of a performance or incentive fee).

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**Investment Allocation:** Such potential conflicts include those relating to allocation of investment opportunities. For example, it is possible that an investment opportunity may be suitable for more than one account managed by Babson Capital, but may not be available in sufficient quantities for all accounts to participate fully. Similarly, there may be limited opportunity to sell an investment held by multiple accounts. A conflict arises where the portfolio manager has an incentive to treat an account preferentially because the account pays Babson Capital or its affiliates a performance-based fee or the portfolio manager, Babson Capital or an affiliate has an ownership or other economic interest in the account. As noted above, Babson Capital also acts as an investment manager for certain of its affiliates, including MassMutual. These affiliate accounts co-invest jointly and concurrently with Babson Capital's other advisory clients and therefore share in the allocation of such investment opportunities. To address these conflicts of interest associated with the allocation of trading and investment opportunities, Babson Capital has adopted an Investment Allocation Policy and trade allocation procedures that govern the allocation of portfolio transactions and investment opportunities across multiple advisory accounts, including affiliated accounts. In addition, as noted above, to address these conflicts of interest, Babson Capital has adopted a Side by Side Management of Private Investment Funds and Other Advisory Accounts Policy which requires, among others things, that Babson Capital treat each of its advisory clients in a manner consistent with its fiduciary obligations and prohibits Babson Capital from favoring any particular advisory account as a result of the ownership or economic interests of Babson Capital, its affiliates or employees, in such advisory accounts. Any investment by a Babson Capital employee in one of its private funds is also governed by Babson Capital's Employee Co-Investment Policy, which ensures that any co-investment by a Babson Capital employee is consistent with Babson Capital's Code of Ethics.

**Personal Securities Transactions; Short Sales:** Potential material conflicts of interest may also arise related to the knowledge and timing of an account's trades, investment opportunities and broker selection. Babson Capital and its portfolio managers have information about the size, timing and possible market impact of the trades of each account they manage. It is possible that portfolio managers could use this information for their personal advantage and/or the advantage or disadvantage of various accounts which they manage. For example, a portfolio manager could, or cause a favored account to, "front run" an account's trade or sell short a security for an account immediately prior to another accounts sale of that security. To address these conflicts, Babson Capital has adopted policies and procedures, including a Short Sales Policy, which ensures that the use of short sales by Babson Capital is consistent with Babson Capital's fiduciary obligations to its clients, a Side by Side Management of Private Investment Funds and Other Advisory Accounts Policy, which requires, among other things, that Babson Capital treat each of its advisory clients in a manner consistent with its fiduciary obligations and prohibits Babson Capital from favoring any particular account as a result of the ownership or economic interest of Babson Capital, its affiliates or employees and a Code of Ethics.

**Trade Errors:** Potential material conflicts of interest may also arise if a trade error occurs in a client account. A trade error is deemed to occur if there is a deviation by Babson Capital from the applicable standard of care in connection with the placement, execution or settlement of a trade for an advisory account that results in (1) Babson Capital purchasing securities not permitted or authorized by a client's investment advisory agreement or otherwise failing to follow a client's specific investment directives; (2) Babson Capital purchasing or selling the wrong security or the wrong amount of securities on behalf of a client's account; or (3) Babson Capital purchasing or selling securities for, or allocating securities to, the wrong client account. When correcting these errors, conflicts of interest between Babson Capital and its advisory accounts may arise as decisions are made on whether to cancel, reverse or reallocate the erroneous trades. In order to address these conflicts, Babson Capital has adopted an Errors Policy governing the resolution of trading errors, and will follow the Errors Policy in order to ensure that trade errors are handled promptly and appropriately and that any action taken to remedy an error places the interest of a client ahead of Babson Capital's interest.

**Best Execution; Directed Brokerage:** With respect to securities transactions for most of the accounts it manages, Babson Capital determines which broker to use to execute each order, consistent with its fiduciary duty to seek best execution of the transaction. Babson Capital manages certain accounts, however, for clients who limit its discretion



with respect to the selection of brokers or direct it to execute such client's transaction through a particular broker. In these cases, trades for such an account in a particular security may be placed separately from, rather than aggregated with, those in the same security for other accounts. Placing separate transaction orders for a security may temporarily affect the market price of the security or otherwise affect the execution of the transaction to the possible detriment of one or more of the other account(s) involved. In order to address these conflicts, Babson Capital has adopted a Best Execution Policy, which establishes the necessary controls to satisfy its obligations regarding best execution and ensures it places advisory client trades in such a manner that the advisory client's total costs or proceeds are the most favorable under the circumstances, and a Directed Brokerage Policy, which ensures all directed brokerage instructions are executed in accordance with written client instructions and applicable legal requirements.

Babson Capital and its portfolio managers or employees may have other actual or potential conflicts of interest in managing an advisory account, and the list above is not a complete description of every conflict of interest that could be deemed to exist.

**COMPENSATION.** The current Babson Capital compensation and incentive program for investment professionals is designed to attract, motivate and retain high-performing individuals.

To help Babson Capital make informed decisions, Babson Capital participates in annual compensation surveys of investment management firms using McLagan | Aon Hewitt, in addition to other industry specific resources. The firms selected for periodic peer-group comparisons typically have similar asset size or business mix. Annually, a review is conducted of total compensation versus market, to ensure that individual pay is competitive with the defined overall market.

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The compensation package for the members of the Portfolio Team is comprised of a market-driven base salary, a performance-driven annual bonus, and discretionary long-term incentives. The performance-driven annual bonus is based on the overall performance of Babson Capital as well as the performance of the accounts managed by the members of the Portfolio Team relative to appropriate benchmarks, including with respect to the Registrant, to the Russell 2000 Index and Barclays Capital U.S. Corporate High Yield Index. Performance of the Registrant, like other accounts Portfolio Team members manage, are evaluated on a pre-tax basis, and are reviewed over one and three-year periods, with greater emphasis given to the latter. There are other factors that affect bonus awards to a lesser extent, such as client satisfaction, teamwork, employee individual performance in relation to pre-determined goals, and the assets under management. Such factors are considered as a part of the overall annual bonus evaluation process by the management of Babson Capital.

Long-Term incentives are designed to share with participants the longer-term value created in Babson Capital. Long-term incentives may take the form of deferred cash awards (including deferred cash awards that provide a portfolio manager with the economic equivalent of a "shareholder" interest in Babson Capital by linking the value of the award to a formula which is meant to represent the value of the business), and/or, in the case of a portfolio manager who manages a private investment fund with a performance fee, a deferred cash award or a direct profit sharing interest that results in the portfolio manager receiving amounts based on the amount of the performance fee paid by such fund. These long-term incentives vest over time and are granted annually, based upon the same criteria used to determine the performance-driven annual bonus detailed above. Because the Portfolio Team members are generally responsible for multiple accounts (including the Registrant), they are compensated on the overall performance of the accounts that they manage, rather than a specific account, except for the portion of compensation relating to any performance fee award.

**BENEFICIAL OWNERSHIP.** As of December 31, 2012, members of the Portfolio Team beneficially owned the following dollar range of equity securities in the Registrant:

| Portfolio Team:       | Dollar Range of Beneficially Owned* Equity Securities of the Registrant: |
|-----------------------|--|
| Clifford M. Noreen    | None   |
| Sean Feeley           | None   |
| Michael P. Hermsen    | \$10,001-\$50,000  |
| Michael L. Klofas     | None   |
| Richard E. Spencer II | None   |

\*Beneficial ownership has been determined in accordance with Rule 16a-1(a)(2) under the Securities Exchange Act of 1934, as amended. (Shares "beneficially owned" include the number of shares of the Registrant represented by the value of a Registrant-related investment option under Babson Capital's non-qualified deferred compensation plan for certain officers of Babson Capital (the "Plan"). The Plan has an investment option that derives its value from the market value of the Registrant's shares. However, neither the Plan nor the participation in the Plan has an actual ownership interest in the Registrant's shares.)

**ITEM PURCHASES OF EQUITY SECURITIES BY CLOSED-END MANAGEMENT INVESTMENT  
9. COMPANY AND AFFILIATED PURCHASERS.**

Not applicable for this filing.

**ITEM 10. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.**

Not applicable for this filing.

ITEM 11. CONTROLS AND PROCEDURES.

- (a) The principal executive officer and principal financial officer of the Registrant evaluated the effectiveness of the Registrant's disclosure controls and procedures (as defined in Rule 30a-3(c) under the Investment Company Act of 1940 (the "Act")) as of a date within 90 days of the filing date of this report and based on that evaluation have concluded that such disclosure controls and procedures are effective to provide reasonable assurance that material information required to be disclosed by the Registrant on Form N-CSR is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.
- (b) There were no changes in the Registrant's internal control over financial reporting (as defined in Rule 30a-3(d) under the Act) during the Registrant's second fiscal half year that have materially affected, or are reasonably likely to materially affect, the Registrant's internal control over financial reporting.

ITEM 12. EXHIBITS.

- (a)(1) ANY CODE OF ETHICS, OR AMENDMENTS THERETO, THAT IS THE SUBJECT OF DISCLOSURE REQUIRED BY ITEM 2, TO THE EXTENT THAT THE REGISTRANT INTENDS TO SATISFY THE ITEM 2 REQUIREMENTS THROUGH THE FILING OF AN EXHIBIT.

None.

- (a)(2) A SEPARATE CERTIFICATION FOR EACH PRINCIPAL EXECUTIVE OFFICER AND PRINCIPAL FINANCIAL OFFICER OF THE REGISTRANT AS REQUIRED BY RULE 30a-2 UNDER THE ACT.

Attached hereto as EX-99.31.1

Attached hereto as EX-99.31.2

- (a)(3) ANY WRITTEN SOLICITATION TO PURCHASE SECURITIES UNDER RULE 23c-1 UNDER THE ACT (17 CFR 270.23c-1) SENT OR GIVEN DURING THE PERIOD COVERED BY THE REPORT BY OR ON BEHALF OF THE REGISTRANT TO 10 OR MORE PERSONS.

Not applicable for this filing.

- (b) CERTIFICATIONS PURSUANT TO RULE 302-2(b) UNDER THE ACT.

Attached hereto as EX-99.32

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

(Registrant): Babson Capital Participation Investors

By: /s/ Michael L. Klofas  
Michael L. Klofas, President

Date: March 11, 2013

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

By: /s/ Michael L. Klofas  
Michael L. Klofas, President

Date: March 11, 2013

By: /s/ James M. Roy  
James M. Roy, Vice President and  
Chief Financial Officer

Date: March 11, 2013