

BABSON CAPITAL PARTICIPATION INVESTORS

Form N-30D

November 30, 2015

Babson Capital
Participation Investors

Report for the
Nine Months Ended September 30, 2015

Adviser

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

Transfer Agent & Registrar

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

Independent Registered Public Accounting Firm

KPMG LLP
Boston, Massachusetts 02110

Internet Website

www.babsoncapital.com/mpv

Counsel to the Trust

Ropes & Gray LLP
Boston, Massachusetts 02110

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

Custodian

State Street Bank and Trust Company
Boston, Massachusetts 02116

Investment Objective and Policy

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

The Trust’s investment objective is to maximize total return by providing a high level of current income, the potential for growth of income, and capital appreciation. The Trust’s principal investments are privately placed, below-investment grade, long-term debt obligations purchased directly from their issuers, which tend to be smaller companies. 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 Trust’s total assets

Proxy Voting Policies & Procedures; Proxy Voting Record

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

Legal Matters

The Trust has entered into contractual arrangements with an investment adviser, transfer agent and custodian (collectively “service providers”) who each provide services to the Trust. Shareholders are not parties to, or intended beneficiaries of, these contractual arrangements, and these contractual arrangements are not intended to create any shareholder right to enforce them against the service providers or to seek any remedy under them against the service providers, either directly or on behalf of the Trust.

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 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 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.

Form N-Q

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

Under the Trust's Bylaws, any claims asserted against or on behalf of the Trust, including claims against Trustees and officers must be brought in courts located within the Commonwealth of Massachusetts.

The Trust's registration statement and this shareholder report are not contracts between the Trust and its shareholders and do not give rise to any contractual rights or obligations or any shareholder rights other than any rights conferred explicitly by federal or state securities laws that may not be waived.

Babson Capital Participation Investors

TO OUR SHAREHOLDERS

October 31, 2015

We are pleased to present the September 30, 2015 Quarterly Report of Babson Capital Participation Investors (the "Trust").

The Board of Trustees declared a quarterly dividend of \$0.27 per share, payable on November 13, 2015 to shareholders of record on November 4, 2014. The Trust paid a \$0.27 per share dividend for the preceding quarter. The Trust earned \$0.20 per share of net investment income, including \$0.03 per share of non-recurring charges, for the third quarter of 2015, compared to \$0.25 per share, including \$0.02 per share of non-recurring income, in the previous quarter.

During the third quarter, the net assets of the Trust decreased to \$140,680,541 or \$13.64 per share, compared to \$143,105,029 or \$13.87 per share on June 30, 2015. This translates into a 0.3% total return for the quarter, based on the change in the Trust's net assets assuming the reinvestment of all dividends. Longer term, the Trust returned 9.1%, 12.0%, 12.1%, 11.2% and 12.5% for the 1-, 3-, 5-, 10-, and 25-year time periods, respectively, based on the change in the Trust's net assets assuming the reinvestment of all dividends.

The Trust's share price decreased 1.7% during the quarter, from \$13.87 per share as of June 30, 2015 to \$13.64 per share as of September 30, 2015. The Trust's market price of \$13.20 per share equates to a 3.2% discount below the September 30, 2015 net asset value per share of \$13.64. The Trust's average quarter-end premium for the 3-, 5- and 10-year periods was 4.0%, 9.9% and 8.2%, respectively. U.S. equity markets, as approximated by the Russell 2000 Index, decreased 11.9% for the quarter. U.S. fixed income markets, as approximated by the Barclays Capital U.S. Corporate High Yield Index, decreased 4.9% for the quarter.

The Trust closed four new private placement investments, as well as one add-on investment in an existing portfolio company during the third quarter. The four new investments were in Aurora Parts & Accessories LLC, MC Sign Holdings LLC, Sunvair Aerospace Group, Inc. and Westminster Acquisition LLC, while the add-on investment was in Merex Holding Corporation. A brief description of these investments can be found in the Consolidated Schedule of Investments. The total amount invested by the Trust in these transactions was \$4,646,000.

After two strong quarters of new investment activity for the Trust, new deal closings in the third quarter were comparatively lower. Middle market merger and acquisition activity, a key driver of deal flow for the Trust, was slower in the third quarter than it had been in the prior two quarters. This sluggishness persisted into the fourth quarter, although we believe recent signs indicate a pick up as we approach year-end. Overall, we are pleased with the amount of new investment activity for the Trust in 2015. We expect to at least match last year's level of new deal closings. The dark cloud on the horizon, however, continues to be the high purchase prices and leverage levels that are common in buyout transactions today. Average purchase price multiples for small companies, which had been at their highest levels in the past 15 years, went even higher in the third quarter. Leverage multiples have also been worrisomely high and, in the third quarter, actually exceeded the peaks we saw back in 2007. Though we are actively making new investments on behalf of the Trust in this market, we do so cautiously and with discipline, consistent with our longstanding investment philosophy of seeking to take prudent levels of risk and getting paid appropriately for the risk taken. We are not willing to provide financial leverage at levels that we believe are imprudent. This approach has served us well over the long term and through all kinds of market cycles.

The condition of the Trust's existing portfolio remained solid through the third quarter. We once again had more credit upgrades than downgrades during the quarter. The number of companies on our watch list and in default continues to

be at or near the lowest level we have seen over the last five years. We exited six investments during the quarter, and benefited from the partial sale of our holdings in one additional company. We continue to have a backlog of portfolio companies that are in the process of being sold, with two companies already having been sold in October and a few more expected to close by year-end. We had three portfolio companies fully or partially prepay their debt instruments held by the Trust during the quarter. This lower level of prepayment activity is welcome after the unprecedented levels of prepayments we experienced in 2013 and early 2014.

The Trust was able to maintain its \$0.27 per share quarterly dividend for the third quarter even though net investment income per share, excluding non-recurring items, was once again below the dividend rate. Net investment income per share from recurring sources has been below the dividend rate for every quarter since the second quarter of 2012. As we have discussed in prior reports, net investment income has been down due to the considerable reduction in the number of private debt securities in the portfolio resulting from the high level of exit and prepayment activity that occurred in 2013 and 2014. Despite several strong quarters of new investment activity, we have not been able to grow

(Continued)

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the portfolio enough to offset this ongoing effect. It is unlikely that we will be able to rebuild the private portfolio back to its former size and net income-producing capability in the near term. We have been able to maintain the \$0.27 per share quarterly dividend with current income, non-recurring income and earnings carried forward from prior quarters. Over time, however, the Trust's dividend-paying ability tends to be correlated with its recurring earnings capacity. Absent non-recurring items, earnings available for the quarterly dividend would have been \$0.23 per share for the third quarter. This quarter, the Trust's earnings were impacted by \$0.03 per share of non-recurring charges, which required utilization of \$0.07 per share of earnings carry-forwards to maintain the \$0.27 per share quarterly dividend. The Trust's earnings carry-forward was effectively depleted this quarter. Fortunately, though we cannot rely on non-recurring income due to its unpredictable nature, it seems likely that we will realize additional non-recurring income in the fourth quarter, which we believe will enable us to maintain the \$0.27 per share dividend for the fourth quarter. However, it continues to appear likely that we will have to reduce the dividend from the current \$0.27 per share quarterly rate in 2016. As we move forward, we and the Board of Trustees will continue to evaluate the current and future earnings capacity of the Trust and formulate a dividend strategy that is consistent with that earnings level.

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

Sincerely,

Michael L. Klofas
President

Portfolio Composition as of 9/30/2015*

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

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

Babson Capital Participation Investors
CONSOLIDATED STATEMENT OF ASSETS AND LIABILITIES
September 30, 2015
(Unaudited)

Assets:

Investments

(See Consolidated Schedule of Investments)

Corporate restricted securities at fair value (Cost - \$89,726,091)	\$91,364,667
Corporate restricted securities at market value (Cost - \$19,550,639)	18,674,349
Corporate public securities at market value (Cost - \$31,596,549)	30,082,446
Short-term securities at amortized cost	2,000,000
Total investments (Cost - \$142,873,279)	142,121,462
Cash	13,485,736
Interest receivable	1,424,329
Other assets	6,199
Total assets	157,037,726

Liabilities:

Note payable	15,000,000
Payable for investments purchased	498,625
Investment advisory fee payable	316,531
Tax payable	140,548
Deferred tax liability	92,535
Interest payable	27,267
Accrued expenses	281,679
Total liabilities	16,357,185
Total net assets	\$ 140,680,541

Net Assets:

Common shares, par value \$.01 per share	\$ 103,148
Additional paid-in capital	97,901,079
Retained net realized gain on investments, prior years	40,289,888
Undistributed net investment income	2,500,792
Accumulated net realized gain on investments	729,986
Net unrealized depreciation of investments	(844,352)
Total net assets	\$ 140,680,541
Common shares issued and outstanding (14,787,750 authorized)	10,314,898
Net asset value per share	\$ 13.64

See Notes to Consolidated Financial Statements

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CONSOLIDATED STATEMENT OF OPERATIONS

For the nine months ended September 30, 2015

(Unaudited)

Investment Income:	
Interest	\$8,864,084
Dividends	368,705
Other	78,773
Total investment income	9,311,562
Expenses:	
Investment advisory fees	961,852
Interest	460,125
Professional fees	180,413
Trustees' fees and expenses	174,000
Reports to shareholders	56,000
Custodian fees	20,064
Other	145,050
Total expenses	1,997,504
Investment income - net	7,314,058
Net realized and unrealized gain on investments:	
Net realized gain on investments before taxes	1,441,822
Income tax expense	(58,892)
Net realized gain on investments after taxes	1,382,930
Net change in unrealized depreciation of investments before taxes	(517,634)
Net change in deferred income tax expense	317,084
Net change in unrealized depreciation of investments after taxes	(200,550)
Net gain on investments	1,182,380
Net increase in net assets resulting from operations	\$8,496,438

See Notes to Consolidated Financial Statements

Babson Capital Participation Investors
CONSOLIDATED STATEMENT OF CASH FLOWS
For the nine months ended September 30, 2015
(Unaudited)

Net increase in cash:

Cash flows from operating activities:

Purchases/Proceeds/Maturities from short-term portfolio securities, net	\$	4,508,839
Purchases of portfolio securities		(30,317,483)
Proceeds from disposition of portfolio securities		35,833,072
Interest, dividends and other income received		8,478,865
Interest expense paid		(460,125)
Operating expenses paid		(1,483,793)
Income taxes paid		(1,366,629)
Net cash provided by operating activities		15,192,746